No. 305

IN THE

Supreme Court of the United States,

OCTOBER, 1925.

AMERICAN RAILWAY EXPRESS COMPANY,

Defendant-Appellant,

—against—

COMMONWEALTH OF KENTUCKY,

Plaintiff-Respondent.

APPELLANT'S BRIEF ON REARGUMENT.

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SUBJECT INDEX.

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Statement.

This case comes before this Court on a review by certiorari of a judgment of the Court of Appeals of Kentucky affirming a judgment in favor of the plaintiff-respondent in an action brought by the Commonwealth of Kentucky against the defendant-appellant, American Railway Express Company, on which a reargument is ordered by this Court.

The action was brought in equity to hold the American Railway Express Company liable for the amount of a judgment theretofore secured by the Commonwealth of Kentucky against the Adams Express Company, on which execution had been returned unsatisfied.

This is the second case of this character to come before this Court, the first having been brought up on

writ of error and dismissed for lack of jurisdiction on October 8, 1923, on the ground that the plaintiff's only remedy was by certiorari.

Testimony in the previous case is by stipulation incorporated in the present case and additional testimony has been taken to clear up possible deficiencies of proof in previous record. Since no opinion was rendered by the Kentucky Court of Appeals in affirming the judgment in the instant case, we have set out in full the opinion rendered in the first case in the appendix annexed to this brief. This is the only expression of the Kentucky Court of Appeals setting forth its reason for its decision herein.

The Adams Express Company (hereinafter referred to for convenience as the "Adams") is a joint stock association organized under the common law of New York. Its members or shareholders are unlimitedly liable for the debts and liabilities of the association. It is neither more nor less than a huge general partnership operating under a firm name (R., p. 115). The original claim against the Adams arose under the following circumstances.

In 1916 the local agent of the Adams at Harlan, Kentucky, is alleged to have failed to keep with the particularity demanded by the penal statute of Kentucky certain records with reference to incoming shipments of liquor; and for these alleged failures prosecutions were commenced prior to June 30, 1918, in the name of the Commonwealth of Kentucky against the Adams under such statute. The actions were pending in the Circuit Court of Harlan, Kentucky, until January, 1921, when they were brought to trial, the Adams was convicted and judgment rendered against it for fines amounting in the

aggregate to approximately $3,000 (R., p. 3). In the meantime the Adams transferred to the American Railway Express Company, a Delaware corporation, its operating equipment in the State of Kentucky, and elsewhere, in satisfaction of a subscription by the Adams to the capital stock of American Railway Express Company (R., p. 44). The value of the equipment in Kentucky was $93,000 and the amount of the stock issued to the Adams therefore was less than 1% of the total issued stock of the American Railway Express Company (R., p. 78). (It is not disputed that in the same sale the American Railway Express Company acquired from the Adams property located in other states and cash of the aggregate value of $8,600,000 the total amount of the subscription of the Adams. This fact, however, was not relied upon by the State court in arriving at its conclusion and is quite irrelevant to the present issues.)

These are the simple and undisputed facts upon which the decision of the Kentucky Court of Appeals was based and the only issue involved is a question of law. There is no evidence in the record on which to predicate an intentional assumption of liability of any of the obligations of the Adams by the American Railway Express Company. On the contrary, there is abundant evidence by witnesses competent to testify that the American Express Company never, either by express undertaking or by any course of conduct, assumed any of the obligations of the Adams (R., pp. 35, 43, 75).

We also think that it will be undisputed that there was never any consolidation or merger of the Adams into the American Railway Express Company in either a legal or a practical sense. The total value of the property transferred by the Adams to the American Railway

Express Company on July 1, 1918, including that relevant to this action, was approximately $8,600,000, while the total assets of the Adams at that time were approximately $63,000,000 (R., p. 74). It did not transfer to the American Railway Express Company its foreign business or its money order business. No steps have ever been taken for dissolution of the Adams, and as a matter of fact in March, 1922, it resumed active business operations in the City of New York in the transportation of money and securities (R., p. 75). It has always had its offices in the City of New York at which its executive officers transact the business of the association. No stock of the American Railway Express Company has been distributed to the stockholders of the Adams. It has conducted the investigation and payment of its own claims with the exception of the brief period between July 1, 1918, and February 1, 1919 (R., p. 76). None of the officers of the Adams are officers or employes of the American Railway Express Company, and only four of the twelve directors of the American Railway Express Company are in any way connected with the Adams (R., p. 76). The Adams owns less than one-third of the issued and outstanding stock of the American Railway Express Company. The opinion of the State Court specifically admits that there was no merger or consolidation (Appendix, p. 75). It will, we think, be undisputed that there was no actual fraud in the acquisition by the American Railway Express Company of the operating equipment of the Adams in the State of Kentucky. The circumstances attending the transfer of the property arose out of the exercise by the Director General of Railways of the powers deemed by him necessary for the successful prosecution of the war (R., pp. 71, 74, 33, 35).

On December 28, 1917, the President of the United States acting under the war powers conferred on him by Congress took over all the railroad lines of the United States and vested control of them in his agent the Director General of Railroads. The Adams, Southern, American and Wells Fargo & Company had been operating over railroad lines under contracts, and they immediately made application to the Director General of Railroads to ascertain whether they had been taken over with the railroad lines or if not whether the Government would carry out the contracts of the railroads for express facilities. They were advised that they had not been taken over and that the Director General would not take them over nor allow them to operate on the railroads as separate entities. They were advised that express transportation must be unified to operate over the unified railroad system controlled by the Director General and that a new express company must be organized to act as the agent of the Director General; for that purpose the stock of such new corporation must be subscribed by them respectively and that their property used in carrying on their express transportation business in the United States, but not including cash or treasury assets, must be transferred to such new corporation. The Adams and other Express Companies were thus forced out of business in any case by the requirements of the Director General. They had the choice of selling their domestic operating equipment in a lump as required by the Director General to a new express company or of selling it piecemeal at the various points throughout the United States at which their wagons and other operating equipment were located (R., p. 41).

In such a situation common sense and patriotism alike

dictated the acceptance of the first alternative; and the old express companies on June 21, 1918, entered into an agreement with the Director General in accordance with his requirements whereby they undertook under his direction and control to organize the American Railway Express Company and to subscribe for all its capital stock and to transfer to it all their domestic operating equipment at its fair market value, together with the necessary cash for working capital, in satisfaction of such subscription to stock of the American Railway Express Company at par. This involved the issue to the Adams of about $8,600,000 par value of the stock of the American Railway Express Company and about $25,000,000 to the other Express Companies included in the agreement. On his part the Director General agreed to execute a contract with the American Railway Express Company, making it his agent to operate over the railroad lines under his control. This contract is set forth in full at page 87 of the record. The agreement between the Director General and the old express companies did not provide for the merger or consolidation of the old companies into the new company. In fact, it expressly required them to maintain their corporate existence, and they have done so up to the present time and have continuously owned and dealt with assets which were not sold to the American Railway Express Company (R., p. 43).

These agreements were duly carried out and the Adams subscribed for $8,600,000 par value of stock of the American Railway Express Company and on July 1, 1918, transferred to the American Railway Express Company its tangible property used in its domestic express transportation business in the United States, as well as

about $900,000 in cash and received the stock subscribed for. At the same time approximately $25,000,000 par value of the capital stock of the American Railway Express Company was issued to Wells Fargo & Company, the American Railway Express Company and the Southern Express Company at par upon their respective transfers for their respective domestic operating property and cash working capital paid in by them.

Certainly it cannot be claimed that the American Railway Express Company was a party to any actual fraud. It was formed at the requirement and under the direction of the Director General of Railroads. Not a share of stock was issued for anything except physical property at its fair market value which represented cost less depreciation. If the American Railway Express Company were a party to actual fraud, the Director General of the United States and his entire corps of advisers were also parties to the same fraud, for the transaction was planned and carried out, not only with their approval, but practically at their command. As a matter of fact, the Court of Appeals of Kentucky finds in its decision that there was no actual fraud (Appendix, p. 75). The Court of Appeals of Kentucky did not base its decision upon the ground of merger, express agreement or actual fraud. Its opinion clearly recites the facts and assumption of fact upon which it bases its decision in the following language, in which we have italicized certain assumptions which are without support in the record.

> (a) There was no merger or consolidation of the two companies. The American simply bought, and paid for in its stock, all of the property of every kind, character and description employed

by the Adams in the express business, *and took its place as an express company,* the transaction being untainted by actual fraud of any description.

(b) The American did not pay to the Adams any consideration except the issual of its stock to the Adams to the amount of $8,000,000 *and this stock although delivered to the Adams Company, was delivered to it, as we will assume, to be held by it as trustee for the use and benefit of its stockholders or to be delivered by it to the stockholders in proportion to their respective rights.*

(c) Before the sale, the Adams had ample tangible property, including real estate, in this State out of which the judgment could have been satisfied, and after the sale it had in this State no property of any kind or character that could be subjected to the satisfaction of the judgment; *nor were any of its stockholders residents of this State.*

(d) The Adams had in New York or some other State after the sale assets sufficient in value to satisfy the judgment, *but whether these assets could be subjected to its payment is not certain, nor is it material whether this could or not be done.*

(e) Immediately upon the sale, the Adams ceased to do business as an express company leaving no agent in the State for the service of process but retained its corporate identity *merely for the purpose of winding up its affairs.*

(f) The sale and transfer simply had the effect of putting the American company in consideration of its stock in the possession of all the property used by the Adams and other express companies

in the conduct of their business *and it continued to carry on the express business just as the selling companies had carried it on before the sale.*

(g) *We may also here state that, under our constitution and statutes, the Adams, although a joint stock company organized under the laws of New York, is to be treated in this State as a corporation. Whether its stockholders are personally liable for its debts, as in the case of a partnership, we are not able to say as we are not advised concerning the statutes of New York or the articles of association under which it was organized. And so, under these circumstances, we will treat it as a corporation.*

On these facts, the precise question before us is: will a purchasing corporation that has paid the full purchase price *to the selling corporation* by the issue of its stock to it be responsible in law to the extent of the value of the property received for the *debts or liabilities*, whether liquidated or unliquidated, or sounding in contract or tort, *that were outstanding against the selling corporation at the time of the sale*, when the effect of it is to leave the selling corporation without any property in the state in which the liability accrued to satisfy it, although except for the sale it would have had ample property in the State that could have been subjected to the payment of the liability; and may have property in some other State that could be subjected to the payment of the liability.

The decision of the Court of Appeals of Kentucky, therefore, rests upon two facts which appear in the record and four assumptions which have no support in the record.

The facts are——

1. That the appellant took over all of the operating property of the Adams employed in its domestic express business.

2. That the appellant paid the Adams no consideration except the issue of its stock to the Adams.

The assumptions are——

(a) That the stock delivered to the Adams was distributed among the shareholders of the Adams or delivered to a Trustee for such distribution;

(b) That the Adams was a corporation;

(c) That the Commonwealth of Kentucky was a creditor of the Adams at the time of the sale;

(d) That the stock of appellant was not valid consideration for the property.

The Court held (1) that the property of the Adams within the State of Kentucky was impressed with a trust for the benefit of Kentucky creditors; and (2) that the American Railway Express Company was guilty of constructive fraud in acquiring this property in exchange for its own stock and was not a *bona fide* holder for value, so as to cut off rights of general creditors of the Adams to follow its property for satisfaction of their claims.

The appellant contends that the decision of the State Court deprives it of its property without due process of law, because (1) it proceeds upon a principle of law based on assumptions of fact which are unsupported by

the record; (2) that it attempts to do by judicial decision what would be unconstitutional in a statute of similar effect; and (3) that the decision is contrary to the established principles of common law and is an attempt at judicial legislation under the police power of the State which cannot be retroactively applied to affect vested rights.

POINT I.

The basis of fact upon which the Court of Appeals of Kentucky rested its decision denying the asserted federal right has no support in the record.

The Kentucky Court assumes, first, that the appellant distributed to the shareholders of the Adams Express Company the stock which was the consideration for the transfer of the property of the Adams or delivered such stock to the Adams to be so distributed; second, that the Commonwealth of Kentucky was a creditor of the Adams at the time it transferred its Kentucky property to the American Railway Express Company on July 1, 1918; third, that the Adams was a corporation; fourth, that $8,600,000 par value of appellant's stock was not valuable consideration.

It is impossible to read the Court's opinion in this case without realizing that these assumptions were the cornerstones upon which it constructed its theory that the American Railway Express Company was liable for the debts and liabilities of the Adams Express Company. An examination of the record clearly shows that these

assumptions which were necessary to the decision of the Court are absolutely without support in the record. Not only is the record in this case bare of any evidence tending in the faintest degree to support such assumptions, but it appears clearly and affirmatively from the record that they were contrary to fact.

It appears from the deposition of W. M. Barrett (R., p. 68) that the $8,600,000 of the stock of appellant was issued to the Adams and not to its shareholders; that none of the stock of the American Railway Express Company issued to the Adams, has been distributed to the stockholders of the Adams and that it is still in the treasury of the Adams.

It appears from the plaintiff's petition in equity, filed June 2nd, 1921 (R., p. 1) that the criminal prosecutions against the Adams under subsection 3, Section 2569B of the Kentucky Statutes were still pending in the Harlan Circuit Court on June 30, 1918, and that none of these prosecutions came on for trial until January, 1921.

With reference to the third assumption, the state Court said, in its opinion concerning the prior case (Appendix, p. 76):

> "We may also here state that under the constitution and statutes, the Adams although a joint stock company organized under the laws of New York is to be treated in this state as a corporation. Whether its stockholders are personally liable for its debts, as in the case of a partnership, we are not able to say as we are not advised concerning the statutes of New York or the articles of association under which it was organized.

> And so, under these circumstances, we will treat it as a corporation."

However, to rebut any such presumption in the present case, there was introduced in evidence uncontroverted testimony to the effect that the Adams was a joint stock association organized under the common law in the State of New York, the stockholders of which are fully liable for all the obligations of the association (R., p. 116).

These erroneous assumptions of fact, if material to the decision of the State court, bring the case within the application of the rule that where the decision of the State court, denying the asserted Federal right, has no support in the record it is the duty of this Court to review and correct this error.

Postal Tel. Cable Co. v. *Newport*, 247 U. S. 464, 473:

> "But the question arises, whether the basis of fact upon which the state court rested its decision denying the asserted Federal rights has any support in the record; for if not, it is our duty to review and correct that error."

Southern Pacific v. *Schuyler*, 227 U. S. 611;

N. C. Railway Co. v. *Zachary*, 232 U. S. 248, 259;

Carlson v. *Curtiss*, 234 U. S. 103-106;

Norfolk & Western Railway Co. v. *Conley, Attorney General for the State of West Virginia*, 236 U. S. 605-610;

Interstate Amusement Co. v. *Albert*, 239 U. S. 560-567.

We have, therefore, only to consider whether these unfounded assumptions of fact were the basis upon which the State court rested its decision denying the Federal rights asserted by the appellant.

While the recital by the Kentucky court as "outstanding facts" of these assumptions, contrary to the undisputed affirmative proof, would seem to clearly indicate that these assumptions were necessary to the Court's decision, the further discussion of legal principles in the opinion emphasizes the reliance placed by the Court on these assumptions.

At the outset the Court cites and discusses the following cases:

Camden Interstate Ry. Co. v. *Lee*, 27 Ky. L. R. 75;
Harbison Walker R. Co. v. *McFarland*, 156 Ky. 44;
Jennings Neff & Co. v. *Ice Co.*, 128 Tenn. 231;
Grennell v. *Detroit Gas Co.*, 112 Mich. 70;
Altoona v. *Richardson*, 81 Kansas 717;
Hibernia Ins. Co. v. *St. Louis & Northeastern Transportation Co.*, 13 Fed. 516.

In every one of these cases, the purchasing corporation took over all of the assets of the selling corporation and issued stock therefor to the *stockholders of the selling corporation*, and the Court held that the purchasing corporation was responsible for the debts of the seller.

These decisions cited by the Kentucky court are, of course, perfectly sound in principle; but have no application whatever to the instant case. In every one of

these cited cases the sale was fraudulent, actually or constructively, for the reason common to all of them, that the consideration for the sale of all of the assets of the selling corporation *was not paid to the seller, but to its stockholders.*

No consideration moved to the selling corporation which, *ipso facto*, became insolvent. Its assets at the moment of the sale without consideration became a trust fund from which its creditors were entitled to be satisfied before any distribution was made to its shareholders, and the purchasing corporation was held liable for the debts of the seller to the extent of the property received, *not because the stock given in exchange was not proper consideration* for the sale *but because the purchaser distributed the only assets of the insolvent corporation to its shareholders before creditors* having prior claims *were satisfied.* The Kentucky court in its opinion, page says:

> "It is true that there is no direct evidence that the stockholders of the Adams received or will receive in exchange for their stock the stock of the American that was delivered, as shown by the evidence, to the Adams, but it is fair to assume that this stock was turned over to the Adams for distribution to its stockholders as their rights may appear, because they owned the whole beneficial interest in the property that was given for this stock and the clear inference is that the Adams as a corporate entity holds this stock in trust for its shareholders or to be delivered to them."

This utterance of the Kentucky court very plainly shows not only its confessed assumption without eviden-

tiary support of two of the vital facts upon which it based its opinion, but its absolute reliance upon these assumptions in reaching its decision.

Even if we, like the Kentucky court, indulge the assumption that the Adams is a corporation, and even if we go farther and assume that the acquirement by appellant included all of the assets of the Adams of every kind, the law as laid down by this Court and followed in practically every State in the Union is clear upon the non-liability of the appellant for liabilities of the Adams under the proven facts of the instant case. As said by the Court in *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371:

> "A party may deal with a corporation in respect to its property in the same manner as with an individual owner and with no great danger of being held to have received into his possession property burdened with a trust or lien."

And again in *Graham* v. *La Crosse M. R. Co.*, 102 U. S. 148:

> "The contention that while an individual has supreme dominion over his property, a corporation is a mere trustee holding its property for the benefit of its stockholders and creditors is not sound. * * * The corporation is a distinct entity entitled to hold property exactly as an individual can hold it."

See also:

McDonald v. *Williams*, 174 U. S. 397;
Wabash, St. L. & P. R. Co. v. *Ham*, 114 U. S. 587.

The transaction was admittedly without fraud and the consideration contracted for by its subscription and issued by appellant was stock of the appellant, a corporation having $25,000,000 of property and cash, besides the $8,600,000 of property bought from the Adams. To say that this stock was not valid consideration for the property, is to ignore the obvious facts. Upon the authority of the Kentucky cases cited and discussed by the Court below, as well as the uniform decision of this Court and the Courts of every state in the Union, such an exchange would be valid and no lien would attach. The assumption that the consideration for the transfer of the property; i. e., the stock issued by the appellant, was distributed to the stockholders of the Adams at the time of the sale, however, creates another and a very different case, and we do not see that the circumstance of payment being made in stock upon which the Court below lays such stress, has any bearing upon the liability of the appellant. Let us suppose that the consideration had been distributed among the stockholders of the Adams at the time of the sale (as the Court below assumes with respect to the stock) would the appellant have been able, by showing that the sale had been made for cash, to have relieved itself from the charge that it had diverted trust funds of an insolvent corporation in fraud of its creditors? We think it would have no better defense to that charge than it would have if the assumptions of the Court below were the proven fact, and it had distributed the stock to the Adams stockholders.

It would seem, therefore, that the assumption of the distribution of the consideration among the shareholders of the Adams is one of the most important facts

in this case and that the decision of the Kentucky Court rests absolutely upon this assumption.

We frankly admit that if the Adams were a corporation and the appellant had bought all of its property under an agreement to issue its stock to the shareholders of the Adams direct, we would not be here on this appeal. We concede that in such case the distribution to the shareholders would amount to a diversion of trust funds for which we would be liable to the creditors of the Adams to the extent of the property so purchased. But the case apparently considered by the Kentucky Court of Appeals is not the case before this Court. The evidence is clear and competent and without contradiction that there was no such distribution; that the Adams was solvent before and after the sale and is now and has ever since the sale been the owner of the shares of stock received by it for its property, with ample funds outside of such stock to meet all of its liabilities; and finally that it is not and never has been a corporation.

With respect to the second assumption, the Court of Appeals of Kentucky wrongfully assumed that the Commonwealth of Kentucky was a creditor of the Adams Express Company on July 1, 1918. Since the decision was admittedly for the protection of the rights of creditors this was an assumption of the very fact upon which judgment was rendered against the appellant. It should be remembered that the judgments obtained against the Adams Express Company represented fines recovered in prosecutions under a penal statute of the State of Kentucky and *were not recovered until long after the transfer of the Adams property.* While these prosecutions were begun prior to July 1, 1918, they had been allowed to lie dormant until 1921, over two years after the trans-

fer to the American Railway Express Company of the Kentucky property of the Adams Express Company. There is no statute of the State of Kentucky, making such prosecutions a lien on the property of the accused. Under such circumstances we submit that the Commonwealth of Kentucky was not a creditor of the Adams Express Company on July 1, 1918. Even if the petitioner had known of the pendency of these actions, *there was a presumption that the Adams Express Company was not guilty until convicted.* A penal action is a criminal prosecution, *L. & N. R. R.* v. *Commonwealth*, 112 Ky. 635, and it is a well settled rule that the doctrine of *lis pendens* does not bind a transferee where the vendor is the subject of a criminal prosecution, *Farly* v. *Wurz*, 217 N. Y. 105.

> "If the judgment of conviction had been rendered while Russ was the holder of the certificate (Liquor Tax Law 15, subd. 8), a different question would be before us. But a judgment rendered on a plea of guilty after the transfer of the certificate is not evidence against the new holder. As against him, the violation of law must be established by independent evidence. The rule that an estoppel binds privies as well as parties 'applies only to a privity arising after the event out of which the estoppel arises' (*Masten* v. *Olcott*, 101 N. Y. 152, 161; *Zoeller* v. *Riley*, 100 N. Y. 102, 109; *Keokuk & W. R. R. Co.* v. *Missouri*, 152 U. S. 301, 314).
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> If the equitable doctrine of *lis pendens* is ever applicable to such certificates (*Holbrook* v. *New Jersey Zinc Co.*, 57 N. Y. 616, 629, 630; *Presido County* v. *Noel-Young Bond & Stock Co.*, 212 U. S. 58, 77), this case is not within it. The criminal prosecution was not a litigation directly affecting

> the *res* acquired by the purchaser" (*Zoeller* v. *Riley, supra*; *Green* v. *Rick*, 121 Pa. St. 130, 141; *Houston* v. *Timmerman*, 17 Ore. 499, 505).

Upon the original argument in the instant case it was suggested that the case of *Pierce* v. *United States*, 255 U. S. 398, was a direct authority against appellant's point.

It is true that in that case it was held by this Court that a judgment for a fine imposed upon conviction of the Waters-Pierce Oil Company, on which execution had been issued and returned *nulla bona*, could be recovered against the shareholders of the corporation to whom the assets of the corporation had been distributed several months prior to its conviction. This case, however, hinged upon the construction of Section 1041 of the Revised Statutes that judgments for penalties "may be enforced by execution against the property of the defendant in like manner as judgments in civil cases are enforced" and the Court held that the statute was broad enough to support a creditor's bill, and affirmed judgment against the shareholders saying:

> "The law which sends a corporation into the world with the capacity to act imposes upon its assets liability for its acts. The corporation cannot disable itself from responding *by distributing its property among its stockholders and leaving remediless those having valid claims.* In such a case the claims after being reduced to judgments may be satisfied out of the assets in the hands of the stockholders." (Italics ours.)

The Court further, in discussing the contention that the right to bring a creditor's bill did not exist because

the judgment against the company was not entered in the trial Court until a year after the company had divested itself of the property sought to be reached in this suit, and the Government did not become a creditor at all events until its claim for penalties had ripened into a judgment, said:

> "*But when a corporation divests itself of all its assets by distributing them among the stockholders*, those having unsatisfied claims against it may follow the assets, although the claims were contested and unliquidated at the time when the assets were distributed. It is true that the bill to reach and apply the assets distributed among the stockholders cannot, as a matter of equity, jurisdiction and procedure, be filed until the claim has been reduced to judgment and the execution thereon has been returned unsatisfied. *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371; but, as a matter of substantive law, the right to follow the distributed assets (see *Railroad Co.* v. *Howard*, 7 Wall. 392, 409; *Northern Pacific Ry. Co.* v. *Boyd*, 228 U. S. 482; *Kansas City Southern Ry. Co.* v. *Guardian Trust Co.*, 240 U. S. 166) applies not only to those who are creditors in the commercial sense, but to all who hold unsatisfied claims. A corporation cannot by divesting itself of all property leave remediless the holder of a contingent claim, or the obligee of an executory contract, *Baltimore & Ohio Telegraph Co.* v. *Interstate Telegraph Co.*, 54 Fed. Rep. 50, or the holder of a claim in tort, *Hastings* v. *Drew*, 76 N. Y. 9; *John* v. *Champagne Lumber Co.*, 157 Fed. Rep. 407; and there is no good reason why the United States with a claim for penalties should be in

> a worse plight. Here the stockholders receiving the assets are in the position of volunteers; and there is not even the excuse that they were ignorant of the Government's claim. They were officers of the corporation, and the indictment was pending when the transfer of the assets was made: See *Baltimore & Ohio Telegraph Co.* v. *Interstate Telegraph Co., supra.*" (Italics ours.)

In this case the Waters-Pierce Oil Co. sold all of its assets to the Pierce Oil Company and the proceeds were paid to two trustees for distribution among the shareholders. It will be seen, therefore, that the Waters-Pierce Oil Company by the fact of the sale became insolvent and the sale itself was palpably in fraud of creditors and was a distribution of assets to the shareholders of an insolvent corporation. The shareholders sued were officers of the corporation and had knowledge of the pending contingent claim of the Government for penalties. At the moment of such insolvency a trust attaches for the payment of all creditors before the shareholders receive any of the assets of the insolvent corporation, and the Government pursued these assets in their changed form to satisfy its claim, in preference to following the actual property itself into the hands of the Pierce Oil Company who had agreed to meet the liabilities of the selling corporation. Presumably the Government choose to follow the consideration for the sale into the hands of the shareholders who received it with knowledge of the pending contingent liability, rather than to sue the purchasing corporation who may not have been aware of such contingent liability and whose promise to pay the debts of the corporation may have included only the claims of contract creditors. The

point on which this Court very evidently decided the matter, however, was the fact that the distribution to shareholders was made direct by the purchasing corporation and that the consideration of the sale moved to trustees for the shareholders and not to the corporation itself. Had the case been one in which the purchasing corporation did not specifically or by necessary implication assume the liabilities of the seller, and the consideration of cash and stock in the purchasing corporation been delivered to the selling corporation instead of to its stockholders, the case would then have been on all fours with the instant case, and we venture to say that the Court would not have held the purchasing corporation liable for the penalty in question, but would have said that the remedy of the Government in the recovery of its fine would have been against the selling corporation which was still solvent and able to pay its own liabilities.

With respect to the third assumption, that the Adams Express Company is a corporation, we submit that it involved the very basis upon which the liability of the American Railway Express Company was predicated. The State Court held that the issuance of stock was not a valuable consideration and that therefore the petitioner stands in the position of a donee of the Adams property in Kentucky. However, if this property is to be followed into the hands of a *donee, there must be a trust fund theory*, arising either out of a fraudulent conveyance or the fact that it involves the assets of a *corporation*. Yet this was admittedly not a fraudulent conveyance and it can only be treated as a trust fund under the theory that it concerns corporate assets. As we have seen, it affirmatively appears from the present

record that the Adams Express Company is a joint stock association whose members are unlimitedly liable for its obligations. The statutes of Kentucky which treat it as a corporation, as mentioned in the opinion of the Court of Appeals, are only statutes concerning the manner and basis of taxation. There is no statute of the State of Kentucky which provides for limited liability of the shareholders of the Adams Express Company and such a statute is the only kind which would be relevant to the present issue. If the shareholders of the Adams Express Company were unlimitedly liable for its liabilities in the State of Kentucky—and it affirmatively appears that they were—we submit that its property did not constitute a trust fund for its creditors, so long as it was solvent—that so long as this partnership was solvent it could give its property away, if it so desired, and there would be no liability on the transferee to the creditors of the partnership.

The reason for this distinction is clear upon a moment's analysis. A corporation is a creature of limited liability and the only recourse of its creditors is against its capital stock. It was for this reason that the Courts devised the so-called "trust fund" theory applicable to the capital stock of the corporation, holding that the corporation could not dispose of its capital stock except for a valuable consideration to which its creditors might resort as a substitute for the original capital stock of the corporation. The reason was well pointed out by Mr. Justice Swain of this Court in *Sanger* v. *Upton*, 91 U. S. at page 60, when he said:

> "The capital stock of an incorporated company is a fund set apart for the payment of its debts.

> *It is a substitute for the personal liability which subsists in private copartnerships.* When debts are incurred, a contract arises with the creditors that it shall not be withdrawn or applied, otherwise than upon their demands, until such demands are satisfied. The creditors have a lien upon it in equity. If diverted, they may follow it as far as it can be traced, and subject it to the payment of their claims, except as against holders who have taken it *bona fide* for a valuable consideration and without notice. It is publicly pledged to those who deal with the corporation, for their security." (Italics ours.)

This case was cited with approval and this excerpt was repeated in full in *County of Morgan* v. *Allen*, 103 U. S. 498, 508, and the doctrine has been continuously reaffirmed by this Court and the highest Courts of various states down to the present time.

If a corporation transfer all or a substantial part of its capital assets without receiving a valuable consideration therefor it deprives its creditors of the only recourse they have for the payment of their claims. However, so long as an individual or partnership remains solvent the gratuitous transfer of a part of its property does not deprive the creditors of their recourse against the full individual liability of the partners. The transfer by a partnership of all or a part of the firm assets did not give the creditors a right at common law to follow such assets, *unless it left the firm insolvent.* In such a case the transfer became a fraudulent conveyance to defeat the rights of creditors and voidable as such. It is this same principle which applies to a gratuitous transfer of all the property of a corporation. Such a transfer

ipso facto renders the corporation insolvent and is voidable as to its creditors. However, this presumption of resulting insolvency which it is proper to make in the case of a gratuitous transfer by a corporation because of the corporate attribute of limited liability, cannot be made in the case of a partnership, because in such case the creditors have recourse against the full personal liability of the individual partners. If the present record justified the assumption that the Adams Express Company was left insolvent by the transfer of the Kentucky property or even if it were bare of evidence one way or the other, the assumption of the Kentucky Court might not be erroneous in result although it is in theory. However, it affirmatively appears from the uncontradicted testimony of its Treasurer and President that since July 1, 1918, it has itself paid claims amounting to several million dollars, and has been solvent at all times, irrespective of the enormous assets owned by its several thousand members, who are each and all individually liable for the association's liabilities. Under these circumstances we maintain that the Adams Express Company could have made an outright gift of the property in Kentucky to any one it saw fit and the donee would take it free and clear of the rights of Kentucky creditors. The assumption by the Kentucky Court that the Adams Express Company was a corporation or creature of limited liability was contrary to the facts of the record and absolutely necessary for the remarkable decision arrived at.

With respect to the fourth assumption that the $8,600,000 par value of the stock of the American Railway Express Company was not valuable consideration for the sale of the property, this of course is a question of

fact, and the record shows that the appellant had approximately $25,000,000 of assets in cash and property of the Southern American and Wells Fargo Express Companies (R., p. 22) in addition to the $8,600,000 value of property bought from the Adams, and since it had not begun business until the sale it could have no liabilities outside of its issued stock.

The requirements of the Director General embodied in the contract for its formation (R., p. 48 *et seq.*) were that "no shares of capital stock shall be issued except on payment therefor at par in cash or its equivalent in property at the fair market value thereof. No evidences of indebtedness except ordinary bank or commercial loans for current purposes shall be made or issued by the new corporation without the prior approval in writing of the Director General *nor shall any lien of any kind be placed by it upon any property of the new corporation without the prior approval in writing by the Director General.*" (Italics ours.)

The assumption, therefore, of the Kentucky court that stock of the appellant was not valuable consideration was an assumption of fact not having any support in the record, and contrary to affirmative proof in the record.

The Court in this assumption has apparently been misled by the decisions of Courts in other cases where insolvent corporations, in the effort to escape liability for their debts turned over all their assets to a new corporation in exchange for its stock, which was in fact worthless. Naturally, the cases holding sales invalid for lack of consideration would be just such cases. Every such case must depend upon the particular facts as to whether the stock had value at all and if so, how much. In this case the proof is that appellant's stock was worth par.

We are unable to find any decision, except that of the Court below, in which it has been held that stock was not valuable consideration for a sale merely because it was stock and not some other thing of value.

To take the property of the American Railway Express Company under a decision rendered on such unfounded assumptions is a lack of due process and contrary to the Constitution of the United States.

POINT II.

The Court of Appeals of Kentucky has attempted to establish by judicial decision a rule which would be unconstitutional if created by statute.

(a) *The judgment of the Court below denies petitioner the equal protection of the law in that it deprives the appellant of its equal right as a creditor of the Adams Express Company and gives a preference to the plaintiff-respondent.*

In the instant case, the Adams Express Company, pursuant to its contract with the Director General (R., p. 48) subscribed to $8,600,000 par value of the capital stock of appellant at par, payable partly in property at its fair market value and partly in cash (R., p. 44). The property agreed to be transferred by the Adams in satisfaction of this subscription included all of the property of the Adams in Kentucky, as well as in other states, used in its domestic express business.

The appellant by virtue of this stock subscription of the Adams became a contract creditor of the Adams and as such was entitled to the equal protection of the law in Kentucky as in other states, in enforcing its claim to the property agreed to be transferred to it by the

Adams in satisfaction of its obligation. Had the Adams refused to transfer its Kentucky property, it seems probable that the appellant might have maintained a bill for specific performance notwithstanding it was largely personal property, because the particular property was unique in character and was indispensable to the carrying out of a balanced contract as an agency of the Government in time of national need. Whether or not this be true, the claim of the appellant to this property was at least equal to the claim of any contract creditor in Kentucky and would seem to be clearly superior to any unliquidated claim in tort.

Even if the respondent, therefore was a creditor of the Adams at the time of the transfer of the said property with a claim upon a parity with that of a simple contract creditor, the utmost that could be said is that the claim of the respondent was equal to the claim of the appellant. The judgment of the Kentucky Court of Appeals, however, gives the claim of the respondent a preference over that of the appellant and therefore deprives the appellant of the equal protection of the law, contrary to rights secured under the Federal Constitution.

As said by this Court in *Blake* v. *McClung*, 172 U. S. 239, at page 253:

> "If a State should attempt, by statute regulating the distribution of the property of insolvent individuals among their creditors, to give priority to the claims of such individual creditors as were citizens of that State over the claims of individual creditors, citizens of other States, such legislation would be repugnant to the Constitution upon the ground that it withheld from citizens

of other States as such, and because they were such, privileges granted to citizens of the State enacting it. Can a different principle apply, as between individual citizens of the several States, when the assets to be distributed are the assets of an insolvent private corporation lawfully engaged in business and having the power to contract with citizens residing in States other than the one in which it is located?

It is an established rule of equity that when a corporation becomes insolvent it is so far civilly dead that its property may be administered as a trust fund for the benefit of its stockholders and creditors, *Graham* v. *Railroad Co.*, 102 U. S. 148, 161—not simply of stockholders and creditors residing in a particular State, but all stockholders and creditors of whatever State they may be citizens. * * * In *Hollins* v. *Briarfield Coal & Iron Co.*, 150 U. S. 371, 385, it was observed that a private corporation, when it becomes insolvent, holds its assets subject to somewhat the same kind of equitable lien and trust in favor of its creditors that exists in favor of the creditors of a partnership after becoming insolvent, and that in such case a lien and trust will be enforced by a court of equity in favor of creditors. These principles obtain, no doubt, in Tennessee, and will be applied by its courts in all appropriate cases between citizens of that State, without making any distinction *between them*. Yet the courts of that State are forbidden, by the statute in question, to recognize the right in equity of citizens residing in other States to participate upon terms of equality with citizens of Tennessee in the distribution of the assets of an insolvent foreign corporation lawfully doing business in that State.

> We hold such discrimination against citizens of other States to be repugnant to the second section of the Fourth Article of the Constitution of the United States, although generally speaking, the State has the power to prescribe the conditions upon which foreign corporations may enter its territory for purposes of business. Such a power cannot be exerted with the effect of defeating or impairing rights secured to citizens of the several States by the supreme law of the land. Indeed, all the powers possessed by a State must be exercised consistently with the privileges and immunities granted or protected by the Constitution of the United States."

While it is true that in the case cited, a foreign corporation was denied relief upon the claim that it was deprived of the equal protection of the law, the decision of the Court in respect to this question was based solely upon the ground that the foreign corporation in question was not within the jurisdiction of the State of Tennessee, the validity of whose statute was under discussion, because it was not doing business in that State and was not subject to process in that State.

The clear inference from the decision of the Court and the language used in the discussion at page 261 was that if the Virginia corporation had been doing business within the State of Tennessee, the discrimination against it would have constituted a denial of equal protection of the law.

In this case there is no such difficulty, since the appellant is not only within the jurisdiction of the State of Kentucky by the fact that it did business in that State, but was served with process in the instant case and therefore must be held to have been within the jurisdiction of the Courts of Kentucky.

There are, however, in the instant case, two facts which make the discrimination of the Court below more aggravated. First, the contract of the Adams had been carried out and the property had been transferred to the appellant nearly three years before the respondent sought to establish its claim. Second, the respondent did not secure a conviction of the Adams in the criminal proceedings until more than two years after the transfer of said property and was, therefore, not a creditor of the Adams in any sense at the time of the transfer. If, therefore, as indicated by the decision of this Court in *Blake* v. *McClung*, *supra*, the statute of the State of Kentucky would have been obnoxious to the Federal Constitution, it must clearly appear that the State of Kentucky cannot through any other agency exercise a greater authority than it could through its legislative branch, and that its judgment denies to appellant the equal protection of the law in violation of the Federal Constitution.

> (b) *The decision denies petitioner the equal protection of the law, in so far as it makes a distinction between payment in cash and a bona fide issue of stock.*

Even if we regard the transaction between the appellant and the Adams from the angle of a mere purchase of the property of the latter paid for in the stock of the former without regard to the fact that the appellant stood at the time of the contract of sale in the position of a creditor of the Adams, the judgment of the Kentucky court must, we think, be held to deny petitioner the equal protection of the law.

The conclusion reached by the Kentucky Court of Appeals was that the issuance of stock in exchange for

property is not a valuable consideration so far as the creditors of the original owner of the property are concerned but that if the petitioner had paid cash for the property acquired, it would have been a *bona fide* holder for value and the creditors of the Adams could not have followed the property into the petitioner's hands. Such a conclusion requires the assumption that a trust fund theory is applicable to the property transferred so that the creditors can follow the property into the hands of a *bona fide* donee. However, let us assume for the sake of the argument in this point, that the property of a solvent individual or partnership, segregated in a particular State, is a trust fund for the benefit of his or its creditors in that State, and that these creditors can follow this property into the hands of a *bona fide* donee, even if the individual or firm debtor possesses ample property in other States to satisfy all creditor's claims.

Even under such an assumption, to treat a corporation which pays cash for property as a *bona fide* holder for value, and a corporation which issues its own stock (but less than a controlling interest) as a donee, denies to the latter corporation the equal protection of the laws. If there is no reasonable ground for a distinction between the payment of cash and the *bona fide* issuance of stock (but less than a controlling interest) in exchange for property, the distinction made by the Kentucky Court of Appeals was a denial of the equal protection of the laws. We contend that there is no reasonable distinction between the two under the circumstances of the present case. The circumstances relied on are——

(1) Less than 1/3 of 1% of the total issued stock of the American Railway Express Company

was issued to the Adams Express Company for the property in Kentucky.

(2) 75% of the total amount of stock issued was issued for property equivalent to the full par value, acquired from firms having no connection with the Adams Express Company.

(3) At no time before or after the transfer did the Adams Express Company or the persons controlling it, also control the American Railway Express Company.

(4) There was admittedly no fraudulent intent on the part of any person or corporation to defeat the rights of creditors of the Adams Express Company.

The Court of Appeals practically took the position that the issue of stock by a corporation in exchange for property is a "badge of fraud." While it cited some cases in support of this proposition, it did not reach this conclusion by an analysis of the principles upon which the cases were decided, but rather by examining the facts common to all such cases and seizing upon the common fact of the issuance of stock as the underlying principle of decision. There is perhaps no more prolific source of judicial and scientific error than the so-called selective method of attempting to discover the cause which produces a given effect. Having diagnosed the decisions cited as based on the fact of the issue of stock the Court then proceeded to cast about for additional grounds to bolster up and justify the diagnosis. It is well worth while to stop to examine into the validity of these grounds, because they are mentioned in one or two of the cases cited in the opinion of the State court.

One of these was that the creditors of the seller should not be compelled to look to the stock acquired by their debtor for the satisfaction of their claims, because it would be hard to realize on. However, there is no proof that the stock of the American Railway Express Company did not have an easily ascertained market value. Let us suppose that the consideration for the purchase by the American Railway Express Company had been the delivery to the Adams Express Company of full paid U. S. Steel Co. stock. Could it be contended that this would not have been a valuable consideration? The same objection would be applicable if the petitioner had exchanged real property located in the State of New York for the Kentucky property of the Adams, yet can it be doubted that such a consideration would be a valuable one?

Then the Kentucky court asserted that it would not compel its residents to look outside the State for the satisfaction of their claims against the Adams Express Company. But such an argument would apply with equal validity to a case where the American Railway Express Company paid for the property acquired in cash which was delivered and retained in New York. Yet the Kentucky court admits that if the payment had been made in cash the American Railway Express Company would take the property free and clear of the claims of all creditors in Kentucky.

Neither of these grounds applies with any greater force to the case of a stock issue than they do to a cash payment, and it is clear that we must examine the reasoning of the cases cited by the Kentucky court to test the validity of its conclusion.

We submit that all the cases cited by the Kentucky

court and all the other cases ever decided on the same point have one fact in common, in addition to the mere fact of a stock issue; *i. e., that the purchasing corporation was controlled after the sale by practically the same persons who had controlled the seller.*

It is this fact of practical and actual identity between seller and buyer that has caused the courts in such cases to disregard the sale where the rights of creditors were concerned. Such sales were not *bona fide* because the new corporation was merely the debtor under another guise. In all of the cases cited in the State Court's opinion the stockholders of the selling corporation were practically identical with those of the buying corporation. In most of these cases the stock of the purchasing corporation was distributed directly among the stockholders of the selling corporation. In most of them the transaction is designated as practically a consolidation or merger, which is only another manner of saying that there is identity of control.

The decisions of this Court are very instructive on this point. In *Linn Timber Co.* v. *U. S.*, 236 U. S. 574, land was conveyed to a corporation in exchange for practically all its capital stock and the Government thereafter brought suit to avoid the title on the ground that the vendor's title was fraudulently obtained. One might have expected this Court, if the rule laid down by the Kentucky Court of Appeals, is sound, to set aside the transfer to the company on the simple ground that the issuance of its stock was not a valuable consideration. However, not a word was said to this effect and no intimation given that the Court so thought. The decision was based on the fact that the corporation was but the *alter ego* of the transferror—that they were identical.

On the same ground the transfer was set aside in *McCaskill Co.* v. *U. S.*, 216 U. S. 504 and in *Wilson Coal Co.* v. *U. S.*, 188 Fed. 545. In neither of these cases was there an intimation that the stock issued was not a valuable consideration. In both of them it was the fact of identity between transferror and the transferee that caused the property to be followed into the corporation's hands. An analysis of these opinions clearly indicates that if there had been no identity between the transferror and transferee the corporation's title to the property would have been unassailable.

A simple illustration will serve to test the validity of the proposition that the issuance of stock is not a valuable consideration for the transfer of property. Let us assume that an individual holds certain personal property subject to a secret trust and that he subscribes for capital stock of a newly organized corporation of the par value of the property held in trust. It is assumed that the stock interest so acquired by the trustee is less than a controlling interest in the stock of the corporation, in fact less than 1%, and that the remainder of the capital stock of the corporation is issued to other persons for cash or property equal to the par value of such stock. Under such circumstances could the beneficiary of the secret trust follow the property into the hands of the corporation? We submit that it could not, that the corporation would in such case be a *bona fide* holder for value, and that at most the beneficiary of the secret trust could only treat the stock acquired by the trustee as a substitute for the original trust property. It may be urged that this illustration is not in point because in the present case the Kentucky court held that the petitioner *should have known* that there were probably un-

paid creditors of the Adams, while the illustration concerns a case where the purchasing corporation could not have known that the property constituted a trust fund. However, this distinction does not affect the question of what constitutes a valuable consideration—it bears on the question as to when a transferee is a *bona fide* holder. If the transferee takes from the trustee with notice of the trust, it does not matter how valuable is the consideration paid—the transfer can be avoided at the instance of the beneficiary. For this reason a transfer to a corporation in exchange for a controlling interest in its stock would be voidable, not because the consideration was the issuance of stock, but because the transferee and the transferror are in fact identical.

The true reason for holding that a corporation, which acquires all the assets of another corporation in exchange for the stock of the new corporation, is not a *bona fide* purchaser for value, is not, as some Courts have said, because the stock is not a valuable consideration, but because the new corporation is not a *bona fide* purchaser.

Where there is no legal or practical identity between seller and buyer, the buyer must be regarded as a *bona fide* purchaser in the absence of actual fraud. The fact that a stock issue is present in all the cases holding the purchasing corporation liable is due to the fact that this is the only method of control in the case of a corporation. To say that the American Railway Express Company did not give a valuable consideration to the Adams Express Company when it issued its stock is contrary to both common law and common sense. Without regard to the value of the Kentucky property acquired by the American Railway Express Company from the Adams, this stock had a book value of at least $99.60 per share

on account of property transferred to the American Railway Express Company, other than that belonging to the Adams in Kentucky. In addition to this book value this stock represented a proportionate interest in the franchise and goodwill which must be deemed to be of very considerable value, because the company had the exclusive right to do an express business over practically all the railroad lines of the United States.

The Kentucky court admits that in the present case the property of the Adams could not have been followed if it had been paid for in cash, and thereby it admits what is the actual fact, that there is no such identity between the petitioner, American Railway Express Company, and the Adams as to put the petitioner in the position of a purchaser with notice. *If the Kentucky court had found that the Adams and the petitioner were identical* or if it had held that the transfer of the property was voidable as to creditors, as a diversion of a trust fund, whether it was paid for in cash or stock, we could not assail it as discriminatory and a denial to petitioner of equal protection of the laws. However, when it laid down the rule that the transfer would be immune from attack if the consideration were cash, but subject to attack, if it were stock, we submit that since there is no reasonable ground for a distinction between the two under the facts of the present case, there is a discrimination against the petitioner and a denial of the equal protection of the laws. Could a decision of a State court, in effect setting aside a transfer to a corporation on the ground that it was paid for in $10 bills be supported if it were announced that the transfer would have been proper if paid for in $1 bills? Yet no more valid distinction in principle can be pointed out between payment

in cash or property and issuance of stock (unaccompanied by a controlling interest).

Moreover, it is apparent that the decision of the State Court denies to petitioners the equal protection of the laws in so far as it distinguishes between a purchase by a corporation and a purchase by an individual. For instance, if John Jones, owning $10,000 par value of American Railway Express Company stock, had delivered it to the Adams Express Company in exchange for its Kentucky property, it does not appear under the decision of the Kentucky Court, that the transaction would have been subject to attack by the Kentucky creditors of the Adams Express Company. But, if the American Railway Express Company issues this amount of stock to the Adams Express Company for the same property, it renders itself liable to the Adams Express Company creditors. Such a distinction has no support in either reason or law. It only illustrates in another form the discriminatory effect and actual injustice of the Kentucky Court's decision.

If the rule announced by the Kentucky Court of Appeals would have been unconstitutional as a statute, it seems clear that this Court can review it if its effect is to deny to petitioner the equal protection of the laws or deprive him of property without due process of law.

Prudential Ins. Co. v. *Cheek*, 259 U. S. 529:

> "It seems to us clear that the state might without conflict with the 14th Amendment, enact through its legislative department a statute precisely to the same effect as the rule of law and public policy declared by its court of last resort. And, for the purposes of our jurisdiction, it makes

> no difference under the Amendment, through what department the state has acted. The decision is as valid as a statute would be. No question of 'equal protection' is raised here."

(c) *The decision deprives petitioner of its property without due process of law by imposing harsh and unreasonable restriction on the acquisition of property.*

For the purpose of argument under this point we shall assume the validity of principle to which we referred in the preceding paragraphs, *i. e.*, that the *bona fide* issue of stock by a corporation in exchange for property is as much a valuable consideration as the payment of cash or property.

The question is then whether a state can enact a rule that where a corporation purchases property, which happens to be all the property belonging to the seller in a particular state, this corporation is liable to the seller's creditors in that state.

Such a rule is on its face a drastic one, but it is the effect of the Kentucky Court's decision, if we do not discriminate between a *bona fide* stock issue and a cash payment. As a matter of fact, unless there is a reasonable basis for distinction the rule must be deemed to apply to individual purchasers as well as Corporations. The real question for decision is, therefore, whether a sale of all the assets within a particular state of a solvent partnership can be made void as to creditors of the partnership, either by statute or judicial decision.

There are no cases directly in point because up to the present case, no state had attempted to create such a rule of law. This in itself is some support for the conclusion that it is a harsh and unreasonable rule.

However, considerable light on the principles involved can be obtained by an examination of the decisions of this Court with reference to the constitutionality of the "Bulk Sales Laws" enacted by many states.

These laws apply to circumstances which have some elements in common with the present case. They apply to instances where the vendor is disposing of an entire stock in trade, presumably the only assets in the state to which his creditors can look for satisfaction of their claims, and the purchaser may be in actual fact a *bona fide* purchaser for value. In these respects they resemble the present case. However, all such laws provide a method by which the purchaser can take a good title to the goods. In some the requirement is the filing of a statement with the town clerk, in others it involves a demand for a list of creditors and mailing of notices to them. When these formalities are complied with the purchaser can take the goods free of any claims of the seller's creditors. However, the rule in the present case provides no method by which the purchasing corporation can acquire a clear title to the property transferred.

These "Bulk Sales Laws" spring from the same commendable desire to protect the rights of creditors which underlies the decision of the Court in this case. We have no quarrel with the motive which creates such statutes or decisions but even a commendable motive cannot justify a wrong action. There are other rights beside those of creditors and the rights of an innocent purchaser for value rank at least as high, if not higher, than those of the vendor's creditors. Such rights may be qualified, *within reason*, as has been done in the "Bulk Sales Acts," but we do not believe they can be wiped out altogether. The state may prescribe regulations to be

complied with in the transfer of all the property of a vendor, such as notices to creditors, filing of inventories, etc., but no state has hitherto gone so far as to hold that all transfers of all the property of the vendor are void as to his creditors irrespective of the transferor's solvency. This Court has upheld "Bulk Sales Acts" which provided for reasonable formalities in connection with the transfer of a vendor's property in bulk but its opinions have clearly indicated that there could be such a thing as an unreasonable restriction. The decisions have held the statutes in question to be within the reasonable exercise of the police power of the state rather than a matter absolutely within the state's control, over the exercise of which this Court had no power of supervision.

In the case of *Lemieux* v. *Young, Trustee*, 211 U. S. 489, in holding the Connecticut Bulk Sales Law constitutional, this Court said:

> "As the subject to which the statute relates was clearly within the police powers of the State, the statute cannot be held to be repugnant to the due process clause of the Fourteenth Amendment, because of the nature or character of the regulations which the statute embodies, unless it clearly appears that those regulations are so beyond all reasonable relation to the subject to which they are applied as to amount to mere arbitrary usurpation of power. *Booth* v. *Illinois*, 184 U. S. 425. This, we think, is clearly not the case. So, also, as the statute makes a classification based upon a reasonable distinction, and one which, as we have seen, has been generally applied in the exertion of the police power over the subject, there is no foundation for the proposition that the

result of the enforcement of the statute will be to deny the equal protection or the laws."

In the case of *Kidd, Dater & Price Co.* v. *Musselman Grocer Co.*, 217 U. S. 472, this Court quoted the excerpt set out above, saying:

"These principles are decisive against the contentions made in this case, as we do not find in the provisions of the Michigan statute when compared with the Connecticut statute such differences as would warrant us in holding that the regulations of the Michigan statute are so beyond all reasonable relation to the subject to which they are applied as to amount to mere arbitrary usurpation of power. The purpose of both statutes is the same, viz., to prevent the defrauding of creditors by the secret sale of substantially all of a merchant's stock of goods in bulk, and both require notice of such sale and make void as to creditors a sale without notice. The difference between the two statutes are pointed out by counsel in a summary which we excerpt in the margin.

It is apparent, we think, from this summary that the statutes are alike fundamentally, and differ only in minor and incidental provisions. In some respects the Michigan law is more comprehensive than the Connecticut law, as the latter law was limited to retail merchants, while the Michigan law affects wholesalers as well as retailers. The requirements of the Michigan law, that a full and detailed inventory shall be made, does not seem to us to be oppressive and arbitrary, as in *bona fide* purchasers of stocks of goods in bulk a careful purchaser is solicitous to demand such an inventory, and in the purchase

in question an inventory was in fact made. Nor can we say, in view of the ruling in the *Lemieux* case, to the effect that a State may without violating the Constitution of the United States, require that creditors be constructively notified of the proposed sale of a stock of goods in bulk, that a requirement for what is in effect actual notice to each creditor is so unreasonable as to be a mere arbitrary exertion of power beyond the authority of the legislature to exert. We do not deem it necessary to further pursue the subject, as we think it clearly results, from the ruling in *Lemieux* v. *Young*, that the Michigan statute in no way offends against the Constitution of the United States, and therefore that the Court below was right."

As we have seen, the rule laid down in the present case provides for no method for validating the sale. No way is suggested in which the American Railway Express Company could have acquired a good title as against creditors of the Adams, so long as it was stock issued in exchange for the property. The Court does not intimate that it would have altered the situation if the American Railway Express Company had taken a list of the Adams creditors or given notice of the sale to all of them. There is no suggestion on the record that the transaction could have been prevented by the creditors if they had been so informed. Certainly the present plaintiff, as the prosecutor of a pending penal action would have had no grounds for interference. It was admittedly a fair sale, in which the best possible price for the property was obtained. It left the Adams with more to pay its debts than it would have had if the

property had been disposed of piece by piece wherever it happened to be located. Without entering into a discussion of the merits of the plaintiff's claim, it is safe to say that it is not the fault of the petitioner that the Adams has declined to pay some of its alleged creditors.

We submit, therefore, that an attempt on the part of the state to enact by statute the rule that wherever a solvent individual, partnership or corporation sells all of its property located in a particular state to an individual or corporation, the buyer, *ipso facto*, takes such property subject to the claims of the seller's creditors in that state, is so arbitrary and unjust an exercise of the sovereign power of the state as to be a lack of due process of law. This is clearly so in the present case where the purchaser gave full value for the property acquired, the seller remained perfectly solvent and its creditors had their remedy by resort to the debtor's property located in other states—in other words, for the convenience of Kentucky creditors there is arbitrarily imposed upon a *bona fide* purchaser for value liability to Kentucky creditors of the vendor.

POINT III.

Even if the State Legislature could properly enact such a statute, the decision of the State Court is not based upon the principles of common law, but is an attempt at judicial legislation under the police powers of the State, which cannot be applied retroactively to affect vested rights.

(a) *This Court is not bound by the decision of the State Court as to the rules of common law applicable to the present case.*

It should be noted that the decision of the State Court is not based on any statute or constitutional provision of the State of Kentucky and no statutes are cited in its support. Presumably, therefore, it must depend for support upon the principles of common law. However, in the present case, there is no peculiar reason for this Court to defer to the decision of the Kentucky court as to the common law. It is the duty of the Federal courts to determine for themselves questions of commercial law, of general jurisprudence and of rights under the Constitution of the United States.

Swift v. *Tyson*, 16 Pet. 1;
Carpenter v. *Prov. Ins. Co.*, 16 Pet. 495;
Mutual L. Ins. Co. v. *Lane*, 151 Fed. 280, 281, 157 Fed. 1002;
H. Scherer & Co. v. *Everest*, 168 Fed. 822, 832;
Johnson v. *Charles D. Norton Co.*, 159 Fed. 361;
Guernsey v. *Imperial Bank*, 188 Fed. 300-302;
Independent School Dist. v. *Rew*, 111 Fed. 11, and cases cited;
Oates v. *First Nat. Bank*, 100 U. S. 246;
Cudahy Packing Co. v. *State Nat. Bank*, 134 Fed. 538;
First Nat. Bank v. *Liewer*, 187 Fed. 16.

Even if the decision of the Kentucky Court were to be held to have created a fixed rule of property in the State of Kentucky, the decision was made after the rights of the parties had accrued and is not controlling

on the Federal Courts. It is their duty to exercise their independent judgment as to what the common law is.

Great Southern Fire Proof Hotel Co. v. *Jones*, 193 U. S. 532;

Shaw v. *Cleveland, C. C. & St. L. R. Co.*, 173 Fed. 750;

Brewer-Elliott Oil & Gas Co. v. *United States*, 270 Fed. 104;

Babbitt v. *Read*, 236 Fed. 49;

United States ex rel. Pierce v. *Cargill*, 263 Fed. 857;

Newbern v. *National Bank*, 234 Fed. 209.

To make the decisions of the State Court obligatory on the Federal courts, the right must have accrued after the rule has been established.

Shaw v. *Cleveland C. C. & St. L. R. Co.*, 173 Fed. 746;

Adelbert College v. *Wabash R. Co.*, 171 Fed. 813;

Jones v. *Great Southern Fireproof Hotel Co.*, 193 U. S. 532;

Kuhn v. *Fairmont Coal Co.*, 215 U. S. 349;

Hartford County v. *Tome*, 153 Fed. 81;

Fleischmann Co. v. *Murray*, 161 Fed. 162;

Murray v. *Wilson Distillery Co.*, 213 U. S. 151.

In the present case the rule of law established by the Court of Appeals of Kentucky was new, not only to the State of Kentucky, but to the previously enunciated principles of the common law. The rule had previously

been established in Kentucky, where a corporation transferred *all its property* to another corporation in exchange for stock of the new corporation and after such transfer the new corporation was controlled by the persons who had controlled the old corporation, or the stock received was distributed among the stockholders of the old corporation, that the new corporation was liable for the debts of the old, at least to the extent of the property acquired. However, the rule established in the present case extends the imposition of liability to an extent never previously dreamed of. In this case the vendor was a joint stock association whose members are unlimitedly liable for its obligation, the property transferred in Kentucky was less than 1% and all the property transferred was less than 20 per cent. of the total assets of the association; the business transferred was only one branch of that conducted by the association; the stock interest acquired in the new corporation was less than one-third of the issued stock; the persons in control of the association did not control the new corporation; there was no dissolution of the association and the stock received was not distributed among its members; the association thereafter remained in existence and engaged in another line of business for profit.

The old rule laid down by the Kentucky courts held that all the capital assets of a corporation were a trust fund for the benefit of creditors. The new rule asserts that that portion of the assets of a joint stock association located within the State of Kentucky, is, as such, a trust fund for the benefit of Kentucky creditors of the association.

The old rule was applied because of identity of control or the fact of dissolution of the old corporation or

the distribution of the proceeds. The new rule holds that it is immaterial whether or not there is identity of control or the vendor remains in business, or whether or not the proceeds of the sale are distributed among the shareholders of the vendor. The only material thing in the view of the new rule is that it is *stock* of the new corporation which is issued in exchange for the property transferred. Whether or not the new rule is the logical extension of the old one, it is still clear that *it is a new rule.* No one could have known under the old rule that the present transaction would have made the American Railway Express Company liable for the obligations of the Adams. Can it be said that the new rule is self-evidently included in the old one, when the Supreme Court of North Carolina has held on a similar record that the old rule does not apply to this case? *McAllister* v. *American Railway Express Co.*, 103 S. E. 129. Even if it can be held to be a rule of property, the rule laid down by the Kentucky Court is a new one, it was rendered after rights had vested in the present case and therefore is not controlling on this Court, which can determine for itself whether or not the decision is justifiable under the well established principles of the Common Law.

(b) *The decision of the State Court cannot be justified under the principles of common law.*

The general rule is that a corporation which purchases all the property of another corporation is not *ipso facto* liable for the debts of the latter.

Postal Telegraph Co. v. *Newport*, 247 U. S. 464;

Gray v. *National Steamship Co.*, 115 U. S. 116;

Racine, etc. Co. v. *Confectioners' Mfg. Co.*, 234 Fed. 876;
Koch v. *Speedwell*, 140 Pac. 598 (Cal.);
Buckler v. *United States, etc. Co.*, 112 Atl. 632 (Pa.);
Hageman v. *Southern R. R. Co.*, 202 Mo. 249;
McAllister v. *American Ry. Express Co.*, 103 S. E. 129 (N. C.);
Swing v. *Empire Lumber Co.*, 105 Minn. 356;
Fogg v. *Blair*, 133 U. S. 534, 541;
Cook on Corporations, 8th Ed. Vol. III, Sec. 673;
Chase v. *Michigan*, 121 Mich. 631;
Austin Co. v. *Smith*, 138 Ga. 651;
Houston v. *Nicolini*, 96 S. W. 84 (Tex.).

Some states have held that there is an exception to this general rule where a corporation transfers *all its property* to another corporation in exchange for *a controlling interest in the stock* of the new corporation and the selling corporation is dissolved or goes out of business. Such were the facts in the cases cited in the opinion of the Kentucky Court of Appeals. The validity of this exception is disputed by very reputable authority:

Hageman v. *Southern Ry.*, 202 Mo. 249;
Swing v. *Empire Lumber Co.*, 105 Minn. 356;
Anderson v. *War*, 8 Idaho, 789;
Ozan L. Co. v. *Davis, etc., Co.*, 284 Fed. 161;
Colorado Springs Co. v. *Albrecht*, 123 Pac. 957;
McAllister v. *Am. Ry. Ex. Co.*, 103 S. E. 129 (N. C.);

Cooper v. *Utah Ry. Co.*, 35 Utah 570;
Homestead Mining Co. v. *Reynolds*, 30 Colorado 330;
Lamkin v. *Baldwin*, 72 Conn. 57.

However, we submit that prior to the decision of this case no court has ever held that the sale of a *small portion of the total assets* of a corporation, which happened to be all the assets of that corporation within a particular state, in exchange for a *minority interest* in the stock of another corporation, makes the purchaser liable to the seller's creditors in that state. Yet such is the abstract principle of law laid down by the Kentucky Court. Such, we say, is the *abstract principle*, because, as applied to the actual facts of the present case, the rule laid down, in effect, was this—that where a corporation purchases from an *admittedly solvent partnership*, having property scattered throughout the United States such portion of its property as happened to be located within the State of Kentucky, issuing in exchange therefore approximately 1/3 of 1% of its issued capital stock, the corporation is liable to the State of Kentucky for the penal liabilities of the partnership to the extent of the property acquired, although there may be no actual identity of any kind between the partnership and corporation. There is very considerable authority for the proposition that even where an *insolvent* partnership turns *all* its assets over to a corporation for a *controlling* interest in the stock of the corporation and goes out of business the partnership creditors cannot set aside the transfer, although they may go against the stock acquired.

Plaut v. *Billings Drew Co.*, 127 Mich. 11;
Re Braus, 248 Fed. 55;

Shumaker v. *Davidson*, 116 Iowa, 569;
Harnan v. *Haight*, 177 N. W. 281 (Mich.);
Fisher v. *Campbell*, 101 Fed. 156;
Troy v. *Morse*, 22 Wash. 280;
Gardiner v. *Haines*, 19 S. D. 514;
Haring v. *Hamilton*, 107 Wis. 112;
Scripps v. *Crawford*, 123 Mich. 172;
Evans v. *Johnson*, 149 Fed. 978.

However, in the present case the partnership is admittedly *solvent*, the assets in the State of Kentucky were only a small portion of the entire assets of the Adams, *no controlling interest was acquired* in the stock of the American Railway Express Company and the Adams remained in existence and is still engaged in business (Record, p. 75). The decision of the Kentucky Court was not necessary to preserve the rights of Adams creditors who had exhausted every other remedy in an effort to collect, but merely *for the convenience of Kentucky creditors.* There must have been countless instances where local creditors would have preferred for their own convenience to satisfy their claims against a non-resident debtor out of property formerly belonging to it, but we have been unable to find a single case that laid down the remarkable rule of this case. The decision is clearly contrary to the fundamental common law and if justifiable at all, must be based upon the right of a state to enact special laws for the protection of its own citizens.

(c) *The decision of the State Court is an attempt at judicial legislation under the State's police power.*

As we have said before, the decision of the Court of

Appeals was not necessary to preserve to a creditor a right of recourse, without which he would have been absolutely unable to *get satisfaction of his claim.* It is not disputed that service could be obtained against the Adams in other jurisdictions than Kentucky or that the Adams was perfectly solvent and able to meet all claims against it. The decision was rendered for the convenience of Kentucky creditors.

It seems clear that the Kentucky Court was actually attempting a piece of judicial legislation on the theory that it was a permissible exercise of the State's police power. It is true that at common law all the capital assets of a corporation constituted a trust fund for the benefit of all the creditors of the corporation, but there was no basis at common law for segregating the assets within a particular state and treating them as a trust fund for the benefit of creditors residing in that State. Yet this is the precise rule announced by the Court of Appeals of Kentucky, and it gives rise to some interesting questions. If it is permissible for a state court of general jurisdiction to treat firm assets within the State as a trust fund for resident creditors, could a local court whose jurisdiction is limited to a municipality, treat such assets within the municipality as a trust fund for the benefit of creditors residing within that municipality? It seems a far stretch to justify such decisions under the common law, irrespective of how justifiable they might be as statutes enacted for the protection of the State's residents.

It seems to us debatable as to whether or not the courts of a State can take into their own hands the enactment of rules deemed to be within the proper limits of the State's police power and we are inclined to believe

that the decision of a court must rest either upon the general principles of common law or upon specific statutes of the State or Federal Government. In other words, the decision of a State court cannot be justified as within the police power of the State when it is admittedly contrary to the principles of the common law, and is not rendered under a State statute enacted under the State's police power. A rather exhaustive search has failed to disclose any decision of a State court which is supported upon this ground.

For instance, could a State court, without any action on the part of the State Legislature, announce the rule that foreign corporations could not sue on contracts made within the State unless they had complied with the technical requirements necessary to domicile them in the State? Could a State court hold that an employe, injured in the performance of his duties, was entitled to compensation, irrespective of whether or not there was any negligence on the part of the employer, in the absence of a legislative enactment of a Workmen's Compensation Law? Could a State court in the absence of a legislative enactment of a Bulk Sales Law hold that the sale of an entire stock of merchandise to a *bona fide* purchaser for value was void as to the seller's creditors, unless certain specified technicalities were complied with? At the most, such clear cases of judicial legislation would be of doubtful validity.

(d) *A statute or rule of judicial decision based only on the State's police power cannot retroactively affect rested rights acquired before the enactment of the rule.*

For the purpose of argument under this point, it is quite immaterial whether or not the State of Kentucky could *in the exercise of its police power* adopt a rule of

law either by judicial decision or statute of the same general purport as the decision sought to be reviewed. If it could not do so, no further argument is necessary to show that the decision is unconstitutional. If it could do so, the rule adopted could not be classed as a part of the common law, but would be an exercise of the sovereign power of the State for the benefit of its citizens.

Even if it be assumed that the Kentucky Court can enact rules of law under the police power it seems clear that such rules will be subject to the same limitations as a statute of similar purport. A State cannot accomplish by judicial decision what it could not accomplish by legislative enactment. One of the principal limitations on the police power is that which prevents the destruction of vested property rights. Let us assume for the sake of argument under this point that at common law the American Railway Express Company would not have been liable for the obligations of the Adams Express Company under the facts of this case—that at common law it would acquire the property of the Adams Express Company free and clear of the claims of any creditors of the Adams Express Company. Then let us assume that on December 10, 1920, the legislature of Kentucky had passed a statute providing that under such circumstances the purchasing corporation should acquire the property subject to a lien in favor of the creditors of the vendor, and that it had been attempted to apply this statute to the acquisition by the American Railway Express Company of the Adams property on July 1, 1918. Can it be doubted that under such circumstances it would be held that the American Railway Express Company had a vested right in the property acquired from the Adams Express Company which the subsequent statute

could not constitutionally impair? It is difficult to see how one could have a stronger case of a vested right of property, which this Court has repeatedly held cannot be impaired by subsequent legislation, even under the admitted police power of the State.

Let us suppose that a State were to enact a "Bulk Sales Law" requiring the purchaser to go through certain formalities in order to take the property free from the claims of the seller's creditors. Could this law be retroactively applied to make void sales effected prior to the passage of the Act? Yet, that is precisely the effect of the Kentucky Court's decision.

The amendment of February 17, 1922, to Section 237 of the Judicial Code clearly indicates that a change in a rule of law established in a State by judicial decision may violate the constitutional rights of a party.

> "In any suit involving the validity of a contract wherein it is claimed that a change in the rule of law, or construction of Statutes by the highest court of a State would be repugnant to the Constitution of the United States, the Supreme Court shall upon writ of error remand, reverse, or affirm the judgment of the State Court, if such claim is set up in the case before the final judgment is entered in the State Court and the decision is *against* the claim so made."

While this amendment, *permitting a writ of error* to this Court, applies only to cases involving the validity of a contract, it recognizes the fact that rights may become vested under one rule of law as laid down by the highest courts of a State and that a change in such a rule of law may be repugnant to the federal constitution.

It is true that the present case does not directly involve the validity of a contract, and so resort to this Court cannot be had upon a writ of error, but it does involve the destruction of vested rights due to a change in the rule of law by the highest court of Kentucky and as such this Court may review it on a writ of certiorari.

POINT IV.

The judgment of the Court of Appeals of Kentucky should be reversed and bill of the plaintiff-respondent should be dismissed.

CHARLES W. STOCKTON,
Attorney for Defendant-Appellant.

BRANCH P. KERFOOT,
Of Counsel.

Appendix.

COURT OF APPEALS OF KENTUCKY

December 10, 1920

AMERICAN RAILWAY EXPRESS COMPANY,
Appellant,

—against—

COMMONWEALTH OF KENTUCKY,
Appellee.

Appeal from Harlan Circuit Court.

Opinion of the Court by Chief Justice Carroll, Affirming:

The purpose of this suit which was brought in July, 1919, by the Commonwealth of Kentucky was to make the American Railway Express Company liable for certain judgments amounting in round numbers to $4,000 obtained by the Commonwealth against The Adams Express Company in the Harlan Circuit Court. The lower Court gave judgment for the amount asked against the American Railway Express Company and to have a reversal of that judgment it prosecutes this appeal.

There is no question made in the record or in the briefs of counsel for the American company as it will be called, as to the regularity of the proceedings in which the judgments were rendered against the Adams company or as to the validity of the judgments against it. The reversal is asked upon the sole ground that under the facts and circumstances of the case, the American company should not be made liable for the payment of the judgments against the Adams company.

Nor is there any disputed issue of fact appearing in the record and this being so the correctness of the judgment appealed from must depend on the principles of law applicable to the case. Before, however, coming to consider the questions of law it will be necessary to set forth the material parts of the pleadings in the case as well as so much of the evidence as shows the circumstances under which the American company acquired the business and property of the Adams company.

The suit was brought by the Commonwealth against the Adams company and the American company and after setting up the judgments against the Adams company and the fact that executions issued on the judgments had been returned by the officer in whose hands they had been placed, "no property found." It was further averred that about June 25, 1918, the defendant American company was organized for the express purpose of taking over and becoming the owner of all the property and rights of the Adams company and other express companies doing a railroad express company business in the United States; that the Adams company on that date transferred and turned over all of its property of every kind, character and description in Kentucky and the United States to the American company and received as the only consideration therefor capital stock of the American company of the par value of $8,000,000; that the Adams company in this transfer and sale delivered to the American company, property situated in Kentucky of the value of many thousands of dollars, including its office and business in the County of Harlan, from which a monthly income of about $10,000 was realized. It was further averred that the American company was indebted to the Adams company on account of dividends due on the stock it transferred to the Adams company in a sum in excess of the amount of the judgment.

On motion of the Adams company the summons issued against it and which was executed on the agent for the American company at Harlan, Kentucky, was quashed upon the ground that he was not at the time of the service of the summons the agent of the Adams company and no appeal is prosecuted from this order.

A general demurrer to the petition filed by the American company was also overruled and thereupon it filed its answer in which after denying in a general way that it was organized for the purpose of taking over the property and business of the Adams company and other express companies and also that the Adams company had transferred to it all of its property of every kind, character and description admitted that "in good faith without fraud and for a valuable consideration the Adams company had transferred and sold its property in the state of Kentucky to the American company."

It further denied that it was indebted to the Adams company in a sum in excess of the judgments as dividends on the stock delivered by it to the Adams company or in any sum on account of or growing out of any other transaction or that it held any property or choses in action or evidences of debt in which the Adams company or its stockholders had any interest.

The affirmative matter in this answer was by agreement denied of record, and so the petition and answer constitute the only pleadings in the case.

Thereafter the depositions of Clark and Degnon, the only witnesses who testified in the case, were taken. Clark, who was an officer of the American company, testified that: On July 1, 1918, the American company purchased from the Adams company and other express companies all of their tangible property used or formerly used in express transportation operations throughout the United States, including the State of Kentucky:

"Q. I believe that you may state in your own way for the information of the court a brief history leading up to the sale and transfer of the property of the Adams company in Kentucky to the American company? A. After continued negotiations at Washington, the Director General of Railroads advised the executives of the express companies that he would not deal with more than one express company to operate over all federal controlled lines in the United States. Therefore, the old express companies were estopped from the right to carry on the express transportation business beyond June 30, 1918. Thereupon a new corporation was organized by the name of the American Railway Express Company which was successful in concluding a contract with the United States Railroad Administration for the operation of the express service over federal controlled lines throughout the United States, such contract to become operative on July 1, 1918.

The old express companies having no use for the tangible property used by them in the express transportation business and the new company having great need for this identical property, which in many respects is peculiar to the express companies negotiated for the sale, the American Railway Express Company contracted for the purchase of this tangible property used in express transportation over all the lines formerly operated by the old express companies, and this purchase and transfer of this tangible property was effected at midnight June 30, 1918, for a valuable consideration on the part of the American Railway Express Company, thereby enabling it to continue the express transportation business without interruption.

Q. I will ask you to state whether or not the Adams Express Company as a corporation, or rather a joint stock company, is or not still in existence with executive officers? A. The Adams Express Company is still in existence as a separate entity, with executive offices and officers in New York City.

Q. Is there or not any contract in existence between the Adams Express Company and the American Railway by the terms of which the American Railway Express Company has agreed, assumed, contracted or undertaken to pay the liabilities, debts and judgments of the Adams Express Company? A. There is not and has not been such a contract.

Q. On July 1, 1918, or about that date, did the American Railway Express Company own any property or have any assets of its own before the property of the other express companies was transferred to it? A. It had not.

Q. What other express companies besides the Adams transferred their property to the American Railway Express Company? A. The Adams Express Company, the American Express Company, the Southern Express Company, Wells Fargo & Company, Great Northern Express Company, Northern Express Company and Western Express Company sold their tangible property used in the express operations to the American Railway Express Company.

Q. What was the whole consideration for this property purchased from these various express companies by the American Railway Express Company? A. Approximately $33,000.

Q. And what was the invoiced or agreed price of the property of the Adams Express Company

turned over to the American Railway Express Company? A. The depreciated book value of each individual piece of property on July 1, 1918.

Q. And what did it amount to in dollars? A. Why, in round numbers, $8,000,000.

Q. I believe you have stated that the Adams Express Company bought some stock and paid cash for it from the American Railway Express Company. How much of the stock did the Adams buy and pay cash for? A. In round numbers between three-quarters of a million and one million dollars.

Q. What did the American Railway Express Company do with the three-quarters of a million dollars which you say the Adams stockholders paid for stock in the American Railway Express Company? A. The cash subscription which was made to the American Railway Express Company for capital stock was used as a working fund with which to carry on its business, purchase supplies and generally to maintain its property.

Q. Can you reasonably find out the value of the Adams Express Company's property that was turned over in Kentucky to the American Railway Express Company? A. No. I cannot. It was all bulk.

Q. To whom was the eight million dollars or more stock of the American Railway Express Company, which represented the value of the property of the Adams Express Company, turned over? A. To the Adams Express Company.

Q. Was it turned over to the individual stockholders of the Adams Express Company or to the Adams Express Company as a joint stock company? A. To the Adams Express Company as a joint stock company."

THOMAS H. DEGNON, an officer of the Adams company, testified as follows:

"Q. Please state whether or not you know whether the Adams Express Company ceased to do an express business on July 1, 1918. A. It did cease.

Q. Is the Adams Express Company still in existence? A. Yes.

Q. Please state whether or not, if you know, the Adams Express Company at the time of the transfer of the property used in the express business in the United States to the American Railway Express Company transferred its entire assets, tangible and intangible of every description to the American Railway Express Company? A. It did not.

Q. Was there any assets reserved by it at the time of this transfer? A. There were.

Q. Has the Adams Express Company in your estimation still assets sufficient to meet its outstanding liabilities? A. I believe it has.

Q. Has it any tangible property to your knowledge? A. It has.

Q. Has it any real estate to your knowledge of which it is the owner? A. Yes.

Q. Did the Adams Express Company on July 1, 1918, retain any property of any kind in Kentucky that it owned at that date? A. It did not.

Q. Has it now any property of any kind in Kentucky? A. It has none to my knowledge.

Q. This suit is to force the collection of judgments rendered by the Harlan Circuit Court, Harlan, Kentucky, against the Adams Express Company, amounting to $4,110.10, including costs. Has the Adams Express Company thought any-

thing about paying these judgments or does it not intend to pay them unless it is forced to do so? A. I don't know anything about it.

Q. About what value of property did the Adams own in Kentucky prior to July 1st, and up to that date—1918? A. I have no knowledge or, rather, recollection.

Q. It did have a business in Kentucky and had property in Kentucky? A. It did.

Q. What kind of property did it own in Kentucky? A. Principally horses, wagons, equipments of various kinds, and, I believe, some real estate.

Q. How was that real estate transferred—by deed or otherwise? A. By deed.

Q. What did the Adams Express Company receive for this property in Kentucky which it transferred to the American Railway Express Company? A. Shares of stock of the American Railway Express Company, either received or to be received.

Q. Were the stockholders of the Adams Express numerous—many of them or only a few? A. Approximately three thousand.

Q. Is the Adams Express Company engaged in any kind of actual business now? A. No.

Q. For what purpose does it still retain its organization as a joint stock company? A. It still has assets undisposed of and also obligations to be settled.

Q. It is retaining its organization for the purpose of winding up its affairs only, is that what I understand you to say? A. That is all it has been doing up to this time.

Q. Do you know what understanding either in writing or otherwise, there existed between the

American Railway Express Company, after July 1, or on July 1, 1918, for the payment of the outstanding obligations of the Adams Express Company at that date? A. There was an understanding between them.

Q. If you know, state what that understanding was in that regard? A. The understanding defined what the American Railway Express Company would undertake to settle outstanding obligations of the Adams Express Company solely for Adams Express Company's account without the assumption of any liability on the part of the American Railway Express Company, the Adams Express Company keeping the American Railway Express Company in funds sufficient to do so.

Q. Do you know the amount of cash for the purchase of the stock of the American Railway Express Company paid by the Adams Express Company? A. Nine hundred thousand and some odd dollars.

Q. Did the Adams Express Company receive from the American Railway Express Company any cash or property consideration for any of its tangible property which the Adams turned over to the American Railway Express Company? A. Not to my knowledge.

Q. The only thing that the Adams company got from the American was stock? A. That is all.

Q. State whether or not in your judgment the Adams Express Company in Kentucky owned and turned over to the American Railway Express Company tangible property of the value of over $5,000? A. I believe so.

Q. Was this sale and transfer of this property in Kentucky by the Adams Express Company

made with the intention to defraud any creditors of the Adams Express Company? A. I do not believe so.

Q. Approximately to the best of your judgment what is the value of the real and tangible property now owned by the Adams Express Company which it did not sell and transfer to the American Railway Express Company? A. According to the recent compilation by accountants, the Company had property of value in round figures $2,700,000 in excess of liabilities which it did not sell or transfer to the American Railway Express Company.

Q. And does the Adams Express Company still own this property? A. The Adams Express Company still owns that property."

On this evidence the outstanding facts in this case may be stated in this way:

(a) There was no merger or consolidation of the two companies. The American simply bought, and paid for in its stock, all of the property of every kind, character and description employed by the Adams in the express business, *and took its place as an express company.* The transaction being untainted by actual fraud of any description.

(b) The American did not pay to the Adams any consideration except the issual of its stock to the Adams to the amount of $8,000,000 *and this stock although delivered to the Adams company was delivered to it, as we will assume, to be held by it as trustee for the use and benefit of its stockholders or to be delivered by it to the stockholders in proportion to their respective rights.*

(c) Before the sale, the Adams had ample tangible property, including real estate, in this State out of which the judgment could have been satisfied, and after the sale it had in this State no property of any kind or character that could be subjected to the satisfaction of the judgment: *nor were any of its stockholders residents of this State.*

(d) The Adams had in New York or some other State after the sale assets sufficient in value to satisfy the judgment, *but whether these assets could be subjected to its payment is not certain, nor is it material whether this could or not be done.*

(e) Immediately upon the sale, the Adams ceased to do business as an express company leaving no agent in the State for the service of process but retained its corporate identity *merely for the purpose of winding up its affairs.*

(f) The sale and transfer simply had the effect of putting the American company in consideration of its stock in the possession of all the property used by the Adams and other express companies in the conduct of their business *and it continued to carry on the express business just as the selling companies had carried it on before the sale.*

(g) *We may also here state that under our constitution, and statutes, the Adams although a joint stock company organized under the laws of New York is to be treated in this State as a corporation. Whether its stockholders are personally liable for its debts, as in the case of a partnership, we are not able to say as we are not*

advised concerning the statutes of New York or the articles of association under which it was organized. And so, under these circumstances, we will treat it as a corporation.

On these facts, the precise question before us is: will a purchasing corporation that has paid the full purchase price *to the selling corporation* by the issue of its stock to it be responsible in law to the extent of the value of the property received, for the *debts or liabilities*, whether liquidated or unliquidated, or sounding in contract or tort, *that were outstanding against the selling corporation at the time of the sale*, when the effect of it is to leave the selling corporation without any property in the state in which the liability accrued to satisfy it, although except for the sale it would have had ample property in the State, that could have been subjected to the payment of the liability; and may have property in some other State that could be subjected to the payment of the liability.

Questions concerning the responsibility of the purchasing corporation for the debts and liabilities of the selling corporation have come before the courts of the country in many cases, and it is held practically without dissent that although the purchasing corporation does not assume the payment of any of the debts or liabilities of the selling corporation, it will yet be made responsible for them if there was no consideration for the sale, or if it was not in good faith but for the purpose of defeating the creditors of the selling corporation, or where there has been a merger or consolidation of the corporations, or where the purchasing corporation took over from the stockholders, all of the stock of the selling corporation, or where the transaction amounts to a mere

re-incorporation or re-organization of the selling corporation.

It is also generally agreed that whe nthese conditions exist the purchasing corporation will be responsible for all the debts and liabilities of the selling corporation without reference to whether these debts or liabilities were created by contract or arose out of tort, or were liquidated or unliquidated.

It is equally well settled that when the sale is a bona fide transaction, and the selling corporation receives money to pay its debts, or property that may be subjected to the payment of its debts and liabilities equal to the fair value of the property conveyed by it the purchasing corporation will not in the absence of a contract obligation or actual fraud of some substantial character be held responsible for the debts or liabilities of the selling corporation. Many illustrative cases fully supporting these propositions may be found in Vol. 5, Thompson on Corporations, Sec. 6517; 7 R. C. L., p. 180; 10 Cyc. 307; Notes in 11 L. R. A. (n. s.) 1119; 32 L. R. A. (n. s.) 616; 47 L. R. A. (n. s.) 1058.

The facts of this case do not however bring it directly within these rules, about which there is no disagreement in the authorities and so the American company can only be made liable, if at all, for the payment of these judgments upon the grounds (*a*) that it was a mere continuation of the Adams under a new name; (*b*) that the only consideration paid to the Adams was paid in the capital stock of the American company and (*c*) that the Adams company on account of the sale has no property or assets of any kind or character in this State that can be subjected to the payment of the judgments. These questions we will now proceed to consider.

In *Camden Interstate Railway Co.* v. *Lee*, 27 Ky. L. R. 75, the facts were these: Lee in a suit to recover

damages for personal injuries obtained in February, 1901, a judgment against the Ashland & Catlettsburg Street Railway Co. upon which an execution was issued and returned "no property found." Rose Hoffman also had a judgment, in a damage suit in February, 1901, against this company. While these suits were pending J. M. Camden purchased the stock of the street railway company under an arrangement with the stockholders by which they agreed to take stock in the Camden Interstate Railway Company in exchange for the stock they held in the street railway company and thereafter a deed was made by the street railway company to the Camden Interstate Railway Company conveying to it all of its property. As a result of this, Lee and Hoffman were unable to obtain satisfaction of their judgments against the street railway company and thereupon sought to make the Camden Interstate Railway Company liable for the judgments. In the sale the Camden company did not assume the payment of any of the debts or liabilities of the street railway company. In holding the Camden company liable, the Court said:

> "The sum of the transaction was that Camden either owned in his own right all the stock of the street railway company by way of purchase, or controlled it under contracts by which the stockholders agreed to take stock in the new company for the stock which they held in the old, and while he thus controlled all the stock in the street railway company, he caused that company to deed all of its property and franchises to the Camden Interstate Railway Co., and thus the stockholders in the street railway company became stockholders in the interstate railway company. In this way the stockholders in the street railway company put

all of their property and franchises in the hands of the interstate railway company, and became stockholders in that company in lieu of the street railway company. By this means, the interstate railway company swallowed up or absorbed the street railway company."

In *Harbison-Walker Refractories Co.* v. *McFarland's Admr.*, 156 Ky. 44, it appears that McFarland's administrator obtained a judgment against a corporation styled Harbison & Walker Company, that was solvent when the liability that resulted in the judgment accrued. After the accrual of the liability the owners of the stock of this company incorporated a new company, and thereafter the stockholders in both of these companies incorporated the Harbison-Walker Refractories Company for the purpose of taking over the property of the other two corporations and doing a like business. Pursuant to this arrangement the Harbison & Walker Company transferred all of its property to the new Harbison & Walker, and this corporation in turn transferred all of its property to the Refractories Company. These several transfers were accomplished merely by the purchasing companies' taking over the assets of the selling companies, and issuing stock of the buying companies to the stockholders of the selling companies in lieu of their stock. After this, the administrator of McFarland brought suit against the Refractories Company to compel it to pay the judgment he had obtained against the Harbison Walker Company; and, in holding it liable for this judgment, the Court said:

"The 'Harbison & Walker Company, Southern Department,' as well as the Portsmouth Harbison-Walker Company, were, in reality, merged into the greater corporation, the Refractories Company, and the method of accomplishing that end

cannot change the rights of creditors, since it resulted in a transfer of all the assets of the first-named company to the Refractories Company, without leaving with the selling company the purchase price of the assets so sold. In the case at bar the Refractories Company took over all the assets of the 'Harbison & Walker Company, Southern Department,' which was the original debtor, leaving it a mere shell, and without leaving with it any money or property whatever as a consideration for the sale of its assets. There was no liquidation of the 'Harbison & Walker Company, Southern Department,' by selling its assets and paying its debts; on the contrary, there was a transfer of all of its property to the Refractories Company without any attempt to pay appellee's debt. A subsidiary corporation cannot thus escape the payment of its liabilities. It is true these sales and transfers were all made by deeds of conveyance, and that the corporation had the right to sell its assets in that way, if it chose so to do; but the decision of this case depends upon the broad equitable principle that where one corporation takes over the assets of another corporation, without paying to it any consideration therefor, as is the fact in this case, the absorbing corporation takes the assets of the absorbed corporation *cum onere*."

In Justice's *Admr.* v. *Catlettsburg Timber Company*, 168 Ky. 665, a creditor of the Catlettsburg Timber Company, sought to hold liable the Dawkins company that purchased the assets and property of the Catlettsburg company, paying therefor a fair and valuable consideration in money. In holding that the purchasing cor-

poration was not liable for the debts of the selling corporation the Court said:

> "The law is well settled that where one corporation voluntarily conveys all its assets to another corporation, and thus practically ceases to exist, without having paid its debts, the purchasing corporation takes the property subject to an equitable lien or charge in favor of the creditors of the selling corporation, who may follow the corporation's assets, or the proceeds thereof, into the hands of whomsoever they can trace them, and subject them to the payment of the corporation's debts, except as against a *bona fide* purchaser for value. The rule does not operate, however, to disturb sales made in good faith, and for value, or in satisfaction of valid liens."

To the same effect is *Martin* v. *Sulfrage*, 159 Ky. 363; *Carter Coal Co.* v. *Clouse*, 163 Ky. 337; *Kentucky Distilleries and Warehouse Company* v. *Webb's Executor*, 181 Ky. 90; *Louisville and Nashville Railroad Co.* v. *Biddell*, 112 Ky. 494.

The case of *Chesapeake & O. Railroad Company* v. *Griest*, 85 Ky. 619, apparently laid down principles somewhat at variance with these later cases but what was said in the *Griest* case was not approved or followed in any of them.

In *Jennings, Neff & Co.* v. *Ice Co.*, 128 Tenn. 231, 47 L. R. A. (n. s.), 1058, it appears that the Crystal Ice Company, a Georgia corporation, transferred all of its property to the Atlantic Ice & Coal Company, a Virginia corporation, and the Crystal Ice Company ceased to do

business but retained its corporate entity for the purpose of winding up its affairs. Prior to this sale, Jennings, Neff & Co. had brought suit against the Crystal Ice Company, and this suit was pending at the time of sale. After the sale, it obtained judgment against the Crystal company, upon which execution issued and was returned "no property found."

In the transaction, the Atlantic company assumed the payment of certain debts of the Crystal company, but not the debt of Jennings, Neff & Company. Aside from this, the only consideration received by the Crystal company for its tangible property in Tennessee, which was valued at about $300,000.00, was stock and bonds of the Atlantic company, which were distributed to the stockholders of the Crystal company. In a suit by Jennings, Neff & Company to make the Atlantic company liable for its judgment against the Crystal company, the Court after stating the familiar doctrine that corporate assets are a trust fund for the payment of the debts of the corporation, a principle that has been time and again announced by this Court, said:

> "It follows that when this purchasing corporation took over in exchange for its own stock and bonds the assets of the other, and permitted these securities which it had substituted for the visible, tangible property of the selling corporation to be distributed among the shareholders of the latter, without provision for the creditors of the latter, it thereby became a party, with full notice, to diversion of a trust fund. As such, the purchasing corporation holds the property so acquired impressed with the same trust with which said property was originally charged, and the purchasing corporation is liable to the creditors of the selling corporation to the extent of the value of the property thus obtained.

Creditors of the old corporation cannot be required to look alone to the stock and bonds which were substituted for the real, tangible assets of that corporation. The value of securities so substituted is more or less problematical, and creditors should not be forced to surrender their claim against available visible assets, and transfer such claim to new securities. Their remedy cannot thus be hindered and impaired for the benefit of stockholders.

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Furthermore, these were securities of a foreign corporation, and were distributed among non-residents of the State, and we are unwilling to approve any device by which tangible property of a corporation located here and subject to the debts of that corporation can be withdrawn from the reach of creditors and distributed among non-resident stockholders. Corporate creditors may not be thus deprived of available security for their claim and forced to resort to difficult and inconvenient litigation in foreign States."

In *Grenell* v. *Detroit Gas Co.*, 112 Mich. 70, a judgment creditor of the Michigan Gas Company sought to make the Detroit Gas Company, the purchaser of the Michigan Gas Company, liable for a judgment against the selling companies. In that case the Detroit Gas Company was organized for the purpose of taking over the business of the Michigan Gas Company, and pursuant to this arranagement it purchased all of the property and assets of the Michigan Gas Company and paid for the same by its shares of stock. The Court said:

"If this transaction be viewed in the light that the defendant appears to desire it to be, viz., that

these corporations are separate entities, and that the Detroit Gas Company purchased the property of the Michigan Gas Company, yet the bill shows that such purchase included all of the property of the vendor. It must have known, or, if not, it was its duty to understand, that nothing was reserved to pay outstanding indebtedness, if there were any. It paid nothing to its vendor for this plant, but dealt with its stockholders, paying to them, in its own capital stock, the price of its purchase; thus, in effect, closing out the corporate business, and dividing its assets among its stockholders. Under such circumstances, we think a legitimate inference is that the purchase was made subject to the application of so much of the property as might be necessary to the payment of the debts of the Michigan Gas Company, if not with the understanding that all debts should be paid by the purchaser. Again, a corporation cannot sell all of its property, and take in payment stock in a new corporation, under an arrangement that has the effect of distributing the assets of the vendor among its stockholders, to the exclusion and prejudice of its creditors; and a company making such a purchase, in consideration of an issue of its own stock to such stockholders, takes the property subject to the rights of creditors. Such an arrangement is a diversion of the trust fund.

It is said that there is nothing to show an intention to defeat the creditors of the Michigan Gas Company, as this was not a liquidated claim at the time this transfer was made. Under the arrangement, the promoters and stockholders of the Detroit Gas Company knew that it was getting

all of the property of the Michigan Gas Company, without provision for its debts, if there were any. It was bound to know that this property was charged with such debts, and ought not to be distributed among the stockholders to the exclusion of creditors. It was a party, then, to a diversion of the trust fund, and, having in its possession such fund, holds it subject to the payment of debts. It canot be called a *bona fide* purchaser of the property, as against existing creditors."

Another instructive case is *Hibernia Insurance Company* v. *St. Louis and New Orleans Transportation Company*, 13 Fed. Rep. 516; in that case it appears that the Babbage Transportation Company sold all of its property to the St. Louis and New Orleans Transportation Company in consideration of stock in the latter company and the payment of certain of its debts. The stockholders in the two companies were substantially identical. The suit was to require the purchasing corporation to pay a debt due by the selling corporation and the Court said:

"The fair inference from the transaction is that the old company was about to be dissolved, and to cease to be. It was to be absorbed by the new company. This is the inevitable consequence of the formation of the new company, composed substantially of the same persons, to transact the same business at the same places, and with the same property. By the transfer, the creditors of the old company were deprived of the means of enforcing their claims. Probably no officers of the old company have since been elected, and it is to be presumed that none will be. This being so, it is at least doubtful whether service of process

could be obtained so as to procure a judgment at law against the old company. And if a judgment were obtained, it could not be collected out of any assets in the possession of the old company because it had turned all its assets over to the new company. It has received, it is true, paid-up stock in the new company, but that has doubtless been disposed of; or, if it has not been, it may at any moment be transferred. Equity will not compel the creditor of a corporation to waive his right to enforce his claim against the visible and tangible property of the corporation, and to run the chances of following and recovering the value of shares of stock after they are placed upon the market.

A distinction with respect to transactions of this character exists between a corporation and a natural person. A natural person may sell all his property for a fair consideration, if the transaction is *bona fide*, and the buyer will not be required to take care that the seller provides for and pays all his debts. A corporation, unlike a natural person, by disposing of all its property, may not only deprive itself of the means of paying its debts, but may deprive itself of corporate existence, and place itself beyond the reach of process at law. At all events, equity cannot permit the owners of one corporation to organize another, and transfer from the former to the latter all the corporate property, without paying all the corporate debts; and that is the exact case now before us.

Here was a corporation engaged in a profitable business, and owning and possessing property valued at $92,000 exclusive of its franchise. It

owed debts confessedly amounting to more or less than the value of its property. It ceases to transact business. Its stockholders organized themselves into another corporation, and all the property is transferred from the old to the new. It matters not that the stockholders in the two companies may not be precisely identical. We are not prepared to say that it would make any difference if the members of the new company were none of them interested in the old. The thing which we pronounce unconscionable is an arrangement by which one corporation takes from another all its property, deprives it of the means of paying its debts, enables it to dissolve its corporate existence and place itself practically beyond the reach of creditors, and this without assuming its liabilities. The fact here, however, appears to be that the owners of the two corporations are substantially identical, and hence there is a still stronger case in equity."

Another very pertinent case is *Altoona* v. *Richardson*, 81 Kan. 717. In that case the Richardson Gas and Oil Company, a corporation, at a time when it was indebted to the City of Altoona transferred all its property to the Altoona Portland Cement Company in consideration of $600,000 of the common stock of the later company which continued the same business the Richardson Company had been engaged in. Thereafter the city sued and obtained judgment against both companies for its indebtedness.

There was no serious question as to the liability of the Richardson Company but the Altoona Company contended that it occupied the attitude of an ordinary purchaser of property and not having contracted to pay

the indebtedness of the Richardson Company it was under no obligation to do so, on the other hand the city insisted that the transaction between the two corporations was a virtual if not a technical consolidation—that the new company was a successor of the old and liable for its debts.

In considering the case and holding the purchasing corporation liable the Court said:

> "In the present case it was not positively and directly proved that the old company distributed among its stockholders the stock in the new company which it received in consideration of the transfer of its property, but that is inferable from the evidence."

And further said:

> "We think it consistent with the weight of authority and in accordance with sound reason to hold that the equitable right of the creditor to look for payment to the property of a debtor corporation is superior to any title that can be acquired through such a transaction as that here disclosed. We affirm the judgment upon the ground that where a corporation becomes practically extinct, transferring all its assets to another and receiving in return stock in the other corporation, which succeeds to its business, the new corporation is liable, to the extent of the value of the property acquired, for the debts of the old one. Such an arrangement is essentially a merger, and should be attended with the same consequences as a consolidation."

In the *Editorial Note to Luedecke* v. *Des Moines, Cabinet Company*, 32 L. R. A. (n. s.), p. 617, it is said, that:

> "The transfer of one corporation to another may amount to a merger in fact although the corporate existence of the transferrer corporation continues. In such case equity looks past the form and at the real effect of the transaction and by an application of the trust-fund doctrine holds the transfer liable to the extent of the assets received as in such case it is not a *bona fide* purchaser for value."

In *Chicago Railroad Company* v. *Taylor*, 183 Ind. 240, the Court said:

> "Where the property is taken without compensation to the original company other than the issuance of stock to it in the new organization the latter should be charged with such unpaid claim as exist against the property taken, at least in an amount equal to the value of such property."

Many other cases announcing principles similar to those set forth in the ones quoted from might be referred to but those noticed are amply sufficient for the purposes of this case and give abundant support to the conclusion we have reached that the American Company should be held liable for the claim sued on.

It is true that in the cases referred to it appeared that the purchasing corporation had bought all the assets and property of the selling corporation, while in this case it appears that the selling corporation has some property in another State but we do not regard this circumstance as sufficient to defeat the wholesome principle running through these cases that the rights

of creditors are superior to the rights of stockholders and a corporation will not be allowed to defeat its just obligations by sale or transfer of its property for no other consideration than stocks or bonds in the purchasing corporation. We have merely extended this wholesome principle for the better protection of creditors and this without prejudice to the rights of selling or purchasing corporations that desire to do what is just by the creditors of the selling corporation.

A careful consideration of the facts in all these cases and the conclusions of the courts makes it clear that the circumstances that *seas* ultimately seized hold of to make the purchasing corporation liable, was that the selling one was paid for its property in the stock of the purchasing corporation, and the property of the selling corporation to which the creditors might look with certainty for the payment of their debts was turned over to the purchasing corporation; and cases involving questions like the one we have, disclose the further fact, that when one corporation sells its property and business to another, it is usually the case, that the selling corporation takes its pay in the stock of the purchasing concern.

But the Court looking through the various forms invented to impart not only validity to the transaction but to save the purchasing corporation from liability for the debts of the selling one, have in almost every case in which the selling corporation received nothing more than stock, held the purchasing corporation liable for the debts of the selling corporation; when however money or property of fair value was delivered as the purchase price, the purchasing corporation in the absence of fraud or contract obligation was relieved from liability.

All the cases also hold that where there is a merger, or consolidation or re-incorporation or re-organization

and a continuance of the business under a new name the corporation taking over the assets and property of the corporation extinguished for all practical purposes will be liable for its debts, and as before said, in virtually all this class of cases, the corporation that went out of business was paid for its property in stock of the new corporation.

Keeping these rulings in mind it is difficult to find any substantial difference between the methods of absorption often employed, as in the case of a merger or re-incorporation or re-organization and a straight out sale like the one here in question when the selling corporation gets nothing but stock in the purchasing one.

It is true there is no direct evidence that the stockholders of the Adams received or will receive in exchange for their stock the stock of the American that was delivered as shown by the evidence to the Adams but it is fair to, and we will, assume that this stock was turned over to the Adams for distribution to its stockholders as their rights may appear because they owned the whole beneficial interest in the property that was given up for this stock and the clear inference is that the Adams as a corporate entity holds this stock in trust for its shareholders or to be delivered to them.

Neither should it be overlooked that the record shows that the American was organized for the sole purpose of taking over the property and business and pursuant to this arrangement did, take over the business and all the property employed therein of the Adams and the other express companies and continued under a new name and a new organization the precise business they were engaged in, nor is it open to doubt that the great bulk of its stock is owned by the stockholders in these old companies although there may be many new share holders. Indeed it would not be wide of the mark to

say that the American under a new name and new organization was merely a continuation of all the old companies as this was in effect the result of the sale and transfer of the business and property.

But it is said that the Adams is yet a corporation and owns property more than sufficient to satisfy its debts. It is true that it yet has a corporate existence but no suit can be maintained against it in this state and all of its property that had a situs in this state has been taken from it. So far as Kentucky creditors are concerned it is nothing more than a mere shell and a very empty one at that. If it owns tangible property of value none of it is in this state and more than likely it has none outside the state that can be seized and subjected by pursuing creditors. At any rate it is plain that the creditors in this state in order to make his debt would be required, to go to the State of New York, and find there if he could, property to satisfy his debt, and then resort to the courts of New York to try to collect it. We say this because the Adams company so far as this record shows has no disposition to pay this debt and we may assume will resort to every possible means to defeat its collection.

Of course, a corporation may sell its property and all of it of every kind, just as any natural person may and when it does this and receives its fair value in money to pay its debts, or property that the creditor can subject to the payment of its debts, a purchaser in the absence of a contract obligation cannot be held for the debts and liabilities of the selling corporation.

But when the selling corporation disposes of all its property and takes for it shares of stock in some other corporation and both the buyer and seller refuse to pay the debts of the seller it is perfectly plain that the rights of creditors of the seller have been prejudiced by the sale, as to them the sale is constructively fraudulent and for

this reason courts, will hold the purchasing corporation liable for the debts of the selling one.

The substantial difference between a corporation and an individual so far as the sale of all its or his property is concerned, is that the corporation is a creature of the law. There is no personal liability. All it has for the payment of its debts is its property and assets and the law, for the protection of creditors has impressed this property with a trust character for the payment of debts and said that the corporation holds it for the benefit of its creditors and when it parts with this property getting in return nothing the creditor can subject, the law will follow the property into the hands of the taker and make it liable to the extent of the value of the property received.

When the American bought the Adams, that company had for years been engaged in an extensive business throughout the United States and the American must have known that it had liabilities, but no provision whatever was made for their payment and it now says to the creditors of the Adams in Kentucky, if you want your money go to the State of New York and try to get it. We will not give our sanction to a scheme like this, and the conclusion we have reached is supported by abundant authority.

Under all the facts and circumstances of this case, the American might well be held liable on the theory that it was merely a continuance of the old companies under a new name. We prefer however to put our decision upon the distinct ground that when one corporation foreign or domestic, takes over the business and property of another that had in this state sufficient tangible property subject to execution to satisfy all its debts in this state and pays for the property so taken over in nothing more than its stock, it becomes liable to state creditors of the selling corporation to the extent of

the value of the property it has received in the sale, although the selling corporation may retain its corporate entity for the purpose of winding up its affairs, and have in some other state, property that might be subjected to the payment of its debts and this upon the ground that such a sale is constructively fraudulent.

This rule is not an unreasonable or harsh one nor will it in any manner interfere with the sale by a corporation of its property and business or subject the purchasing corporation if it uses reasonable care as it may easily do to protect itself from the liabilities of the selling corporation. All it need do is to make arrangements in the articles of sale for the payment of the debts of the selling corporation to the extent of the value of its property conveyed or pay for this property in money or other things of value that the creditors of the selling corporation may look to for the payment of their debts.

In view of the multitude of various enterprises in which corporations are engaged and the fact that creditors can only look to the property of the corporation for the payment of their debts it is nothing more than just and reasonable that the corporation should not be allowed to dispose of its property and business without getting something in return to pay its debts.

In considering this case we have not thus far noticed the authorities relied on by counsel for the American Company, the principal one being *McAlister* v. *The American Railway Express Company*, 103 S. E. Rep. 129. In that case as in this the American Company took over the business and property of the Southern Express Company at the same time and for the same reason and under the same circumstances that it took over the property and business of the Adams Company.

McAlister in that case sought to make the American liable for a claim he had against the Southern. The facts

of the two cases are as nearly alike as the facts of two cases could well be, but the North Carolina Court reached the conclusion that the American Company was not liable, putting its decision upon the ground that the purchasing company in the absence of contract obligation or fraud cannot be held liable for the debts of the selling corporation when there has been no merger or consolidation and the selling corporation does not become extinct and retains sufficient property to pay its debts.

We do not however, find ourselves willing to agree with the North Carolina court although its decision finds some support in the authorities. We are well satisfied that the great weight of modern authority as well as the right of the case supports the conclusion we have reached.

Wherefore the judgment is affirmed.